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No. 12727

United States
Court of Appeals
for the Ninth Circuit.

CALIFORNIA STATE BOARD OF EQUALIZATION,

Appellant.

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of West Coast Cabinet Works, Inc.,

Appellee.

Transcript of Record

**Appeal from the United States District Court,
Southern District of California,
Central Division.**

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

No. 12727

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

LESLIE S. BOWDEN, ESQ.,
548 South Spring Street,
Los Angeles, California,
For Trustee.

FRED N. HOWSER, ESQ.,
Attorney General,
600 State Building,
Los Angeles, California;

JAMES E. SABINE, ESQ.,

DANIEL N. STEVENS, ESQ.,
Deputy Attorney General,
For State of California.

CRAIG, WELLER & LAUGHARN,
Suite 817, 111 West Seventh Street,
Los Angeles 14, California;

HUBERT F. LAUGHARN, ESQ.,

THOMAS TOBIN, ESQ.,
As Amici Curiae.

In the District Court of the United States, Southern District of California, Central Division
In Bankruptcy No. 44,249 W

In the Matter of

WEST COAST CABINET WORKS, INC.,

Bankrupt.

ORDER TO SHOW CAUSE

Upon reading and filing the verified Petition of the Trustee herein, and good cause appearing therefor;

It Is Hereby Ordered: That Wm. G. Bonelli, George R. Reilly, Jas. H. Quinn, Thos. Kuchel, and Richard E. Collins, members of the State Board of Equalization of the State of California, be and appear before the undersigned Referee, Room 343, Federal Building, Los Angeles, California, on the 24th day of October, 1946, at the hour of ten a.m. thereof, or as soon thereafter as counsel may be heard, then and there to show cause if any they have why a permanent Injunction should not be issued against them enjoining and restraining them and each of them from enforcing any of the provisions of the California State Sales Tax against the Trustee herein.

It Is Further Ordered that service of this Order may be made by depositing a copy of same in the United States Post Office, postage prepaid, and addressed to the following persons, to wit: [1*]

***Page numbering appearing at foot of page of original Reporter's Transcript of Record.**

Members of State Board of Equalization:

Wm. G. Bonelli, Los Angeles, California.

George R. Reilly, San Francisco, California.

James H. Quinn, Oakland, California.

Thomas Kuchel, Sacramento, California.

Richard E. Collins, Redding, California.

Secretary of the Board, Dixwell L. Pierce, Sacramento, California.

It Is Further Ordered that said service shall be made at least ten days before the hearing of this Order to Show Cause.

Dated at Los Angeles, California, October 3, 1946.

/s/ HUGH L. DICKSON,
Referee in Bankruptcy.

[Endorsed]: Filed ..... [2]

[Title of District Court and Cause.]

STIPULATION

It Is Hereby Stipulated by and between the Trustee, and the State Board of Equalization of the State of California, through their respective counsel, that an Amended Petition may be filed herein in support of the Trustee's Order to Show Cause heretofore issued out of the above-entitled court, and directed against the State Board of Equalization of the State of California.

Dated: Los Angeles, California, this 31st day of November, 1946.

/s/ LESLIE S. BOWDEN,
Attorney for Trustee.

ROBT. W. KENNY,
Attorney General,

By /s/ DANIEL N. STEVENS,
Deputy Attorney General, Attorney for State Board of Equalization. [3]

It Is So Ordered.

Dated: Los Angeles, California, this 31st day of November, 1946.

/s/ HUGH L. DICKSON,
Referee in Bankruptcy.

[Endorsed]: Filed ..... [4]

[Title of District Court and Cause.]

AMENDED PETITION FOR ORDER TO SHOW CAUSE

The petition of George T. Goggin, respectfully shows:

I.

That he is the duly appointed, acting and qualified Trustee in bankruptcy of the above-entitled bankrupt estate.

II.

That the automobile trucks hereinafter mentioned were not sold by the Trustee herein in conducting the business of the bankrupt estate.

III.

That during the course of the administration of this bankrupt estate, and in liquidating the assets belonging to said bankrupt estate, your petitioner sold in open court certain automobile trucks and received therefor the total sum of Ten Thousand Eight Hundred Seventy-five ($10,875.00) Dollars.

IV.

That subsequent to said sale the State Board of Equalization of the State of California, on September 11, 1946, notified your petitioner that he had become indebted to them in the sum of $276.24, under the provisions of the California State Sales Tax Act, and further that your petitioner is liable for all of the penalties provided by the said California State Sales Tax Act, and particularly for a penalty of 10% of the tax for not making a return of said sales to said State Board of Equalization.

V.

That your petitioner is informed and believes and therefore alleges that in connection with the sales referred to in paragraph III of this petition he is not liable nor required, nor is the bankrupt estate liable or required to comply with any of the provisions of the California State Sales Tax Act, or the rules and regulations of the State Board of Equali-

zation of the State of California in connection therewith.

VI.

That unless an Injunction is issued out of this Court directed against said State Board of Equalization enjoining them from attempting to collect the Sales Tax herein referred to your petitioner is informed and believes and therefore alleges that said State Board of Equalization will continue to assess penalties against your petitioner, and will endeavor to enforce all of the penal provisions against your petitioner as are provided in said California State Sales Tax Act, unless your petitioner complies with the provisions contained therein.

Wherefore your petitioner prays:

That an Order to Show Cause issue out of the above-entitled court directing said State Board of Equalization to appear at a time and place certain to show cause if any they have why they should not be permanently restrained and enjoined [6] from attempting to enforce any of the provisions of the California State Sales Tax Act, or the State Board of Equalization rules and regulations against your petitioner in connection with the sales herein referred to, and for such other and further relief as may be just and equitable in the premises.

/s/ GEO. T. GOGGIN,

Petitioner. [7]

State of California,
County of Los Angeles—ss.

George T. Goggin, being by me first duly sworn, deposes and says: That he is the petitioner in the above-entitled action; that he has read the foregoing Amended Petition and knows the contents thereof; and that the same is true of his own knowledge, except as to the matters which are therein stated on his information or belief, and as to those matters that he believes it to be true.

/s/ GEO. T. GOGGIN.

Subscribed and Sworn to before me this 31st day of October, 1946.

[Seal] /s/ N. E. NAISH,
Notary Public in and for
Said County and State.

[Title of District Court and Cause.]

INJUNCTION

This matter having come on regularly to be heard before the undersigned Referee, on the 14th day of November, at the hour of 10 a.m. thereof, upon the amended petition of the Trustee, Leslie S. Bowden, appearing on behalf of the Trustee, Daniel N. Stevens, Deputy Attorney General, of the State of California, appearing for the Respondents, and evidence both oral and documentary having been introduced on behalf of the parties, and after hearing the arguments of counsel, and being fully ad-

vised in the premises, and the matter having been submitted for decision, I find:

I.

That George T. Goggin is the duly elected, acting and qualified Trustee in Bankruptcy of the above-named bankrupt.

II.

That the Trustee herein, for a limited period of time in connection with the administration of this bankrupt estate conducted the business of said bankrupt, and in the course of [9] the conduct of said business paid to the Respondents herein, all California State Sales Tax required to be paid by him in accordance with the laws of the State of California.

III.

That in liquidating the assets of this estate, the Trustee sold in open court to the highest bidders, a portion of the assets of this estate consisting of automobile trucks, and received therefor the total purchase price of Ten Thousand Eight Hundred Seventy-five ($10,875.00) Dollars. That said sales were duly confirmed by an order of this court. That said automobile trucks were not sold by the Trustee herein in the course of conducting the business of the bankrupt estate.

IV.

That subsequent to the sales of said automobile trucks the Respondents herein notified the Trustee that he had become indebted to them on account of said sales in the sum of Two Hundred Seventy-six

and 24/100 ($276.24) Dollars, for California Sales Tax, calculated by them under the provisions of the California Sales Tax Act. That the Trustee refused to pay the same.

V.

That the Respondents herein have filed no claim in this proceeding for said alleged sales tax, and are attempting to enforce the payment of said Sales Tax as against the Trustee herein.

VI.

That the Trustee is not required to pay to the Respondents herein Sales Tax on said automobile truck sales, for the reason that the said sales were made by the Court in the normal administration of this estate in liquidating the assets for the benefit of the creditors.

VII.

That by reason of the facts, the Trustee has no plain, speedy and adequate remedy at law. [10]

It Is Therefore Ordered that the Respondents herein and each of them be and they are hereby permanently restrained and enjoined from attempting in any manner whatsoever, from enforcing as against the Trustee herein or this bankrupt estate herein, the payment of said sum of Two Hundred Seventy-six and 24/100 ($276.24), or from enforcing or attempting to enforce as against the Trustee

herein or this bankrupt estate, any of the provisions of the California State Sales Tax in connection with the sales herein referred to.

Dated: Los Angeles, California, this 9th day of December, 1946.

/s/ HUGH L. DICKSON,
Referee.

[Endorsed]: Filed Dec. 2, 1946. [11]

[Title of District Court and Cause.]

PETITION OF STATE BOARD OF EQUALIZATION FOR REVIEW OF REFEREE'S ORDER BY JUDGE

To the Honorable Hugh L. Dickson, Referee in Bankruptcy:

Your petitioner, State Board of Equalization of the State of California, by and through the Attorney General of the State of California, respectfully represents as follows:

I.

On October 3, 1946, the above-designated Referee in Bankruptcy, upon the verified petition of George T. Goggin, Trustee in Bankruptcy of the above-entitled bankrupt estate, made and entered an order directing said State Board of Equalization of the State of California to appear before said Referee on the 24th day of October, 1946, and to show cause,

if any exists, why it should not be permanently enjoined from attempting to enforce any of the provisions of the California Sales and Use Tax Law against said Trustee or to collect a retail sales tax measured by the gross receipts of said Trustee from the sale by him of certain automobile trucks [12] which were assets of said bankrupt estate.

II.

After being continued from October 24, 1946, to October 31, 1946, hearing was had upon said order to show cause on the latter date and on November 14, 1946, at which time evidence, both oral and documentary, was introduced and certain facts were stipulated in open court, and the matter was taken under submission.

III.

On the 9th day of December, 1946, a final order was made and entered by the said Referee decreeing that there is no liability for sales tax under the California Sales and Use Tax Law due from said Trustee in Bankruptcy arising from the sale by said Trustee on March 29, 1946, of five trucks owned by said bankrupt and enjoining the State Board of Equalization of the State of California from attempting to collect said tax from said Trustee; a copy of said order is attached, marked "Exhibit A," and made a part hereof by reference.

Assignments of Error

Said order is erroneous for the following reasons:

1. The court erred in rejecting evidence offered

on behalf of your petitioner, to wit: Evidence of the number and character of the sales made by said Trustee during the period beginning March 12, 1946, to and including May 14, 1946.

The rejection of such evidence constitutes error because it is necessary to consider all of the sales made by the Trustee in order to determine whether he is a "retailer" subject to the retail sales tax imposed by the California Sales and Use Tax Law.

2. The court erred in making and entering its finding number II, as follows, to wit:

> "II
>
> "That the Trustee herein, for a limited period of time in connection with the administration of this bankrupt estate conducted the business of said bankrupt, and in the course of the conduct of said business paid to the Respondents herein, all California State Sales Tax required to be paid by him in accordance with the laws of the State of California."

because, for the reasons hereinafter specified in your petitioner's Assignment of Error, said Trustee owes the State of California sales tax, together with accumulated interest as provided by law, measured by the gross receipts from his sales on March 29, 1946, of five trucks used in the bankrupt's business of selling tangible personal property at retail in California.

3. The court erred in making and entering its finding numbered III, as follows, to wit:

"III.

"That in liquidating the assets of this estate, the Trustee sold in open court to the highest bidders, a portion of the assets of this estate consisting of automobile trucks, and received therefor the total purchase price of Ten Thousaid Eight Hundred Seventy-five ($10,875.00) Dollars. That said sales were duly confirmed by an order of this court. That said automobile trucks were not sold by the Trustee herein in the course of conducting the business of the bankrupt estate."

for the reason that there was not sufficient competent [14] evidence to support or warrant said referee in "finding: That said automobile trucks were not sold by the Trustee herein in the course of conducting the business of the bankrupt estate." On the contrary, the evidence offered by your petitioner shows that, in conducting the business of the bankrupt pursuant to court order, said Trustee sold both cabinets and the machinery and equipment used in the manufacture and sale of said cabinets, all of which were assets of said bankrupt's estate.

4. The court erred in making and entering its finding numbered VI, as follows, to wit:

"VI.

"That the Trustee is not required to pay to the Respondents herein Sales Tax on said automobile truck sales, for the reason that the said sales were made by the Court in the normal

administration of this estate in liquidating the assets for the benefit of the creditors."

for the following reasons, to wit:

(1) The evidence shows that said Trustee, in continuing the retail sales business of said bankrupt, was a "retailer," as defined in the California Sales and Use Tax Law, and the gross receipts from his sales of equipment used in the business of selling tangible personal property at retail, including the five trucks sold on March 29, 1946, must be included within the measure of the tax (Bigsby v. Johnson, 18 Cal. 2d 860); and

(2) The evidence shows, or if admitted would show, that said Trustee's sales were of such a [15] number, scope and character as to constitute said Trustee a "retailer," as defined in the California Sales and Use Tax Law, and that his gross receipts from the sale of the five trucks used to deliver to vendees the bankrupt's cabinets must be included within the measure of the tax. (Northwestern Pacific Railroad Co. v. State Board of Equalization, 21 Cal. 2d 524.)

5. The court erred in rejecting evidence offered on behalf of your petitioner, including documentary evidence marked Board's Exhibit Nos. 1 and 3 for identification, of your petitioner's administrative construction and application of the California Sales and Use Tax Law to sales of tangible personal property at retail by trustees in bankruptcy and other

individuals acting in a representative capacity, for the reason that the administrative construction of a statute by the agency authorized and required by law to apply the tax should be accorded great weight and should be followed by the courts unless clearly erroneous.

6. Said order is contrary to law for the reason that Congress has expressly provided by The Act of June 18, 1934 (28 U.S.C.A., Sec. 124a) that a trustee in bankruptcy who conducts any business shall be subject to all State taxes applicable to such business the same as if such business were conducted by an individual or corporation; the evidence shows that the Trustee of the above-entitled bankrupt estate conducted the business of a "retailer" within the purview of the California Sales and Use Tax Law, and said Trustee should be required to pay the tax imposed by that Act measured by his [16] gross receipts from the sales on March 29, 1946, of the five trucks belonging to the bankrupt's estate.

Wherefore, your petitioner prays for a review of said order by the Judge, and that said order be vacated and set aside, and for such other and further relief as the court deems just.

Dated: January 7, 1947.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,
Petitioner.

By FRED N. HOWSER,
Attorney General,
State of California.

/s/ DANIEL N. STEVENS,
Deputy Attorney General.

Attorneys for State Board of Equalization, State of California, Petitioner. [17]

EXHIBIT "A"

In the District Court of the United States, Southern District of California, Central Division
In Bankruptcy No. 44,249 W

In the Matter of

WEST COAST CABINET WORKS, INC.,

Bankrupt.

INJUNCTION

This matter having come on regularly to be heard before the undersigned Referee, on the 14th day of November, at the hour of 10 a.m. thereof, upon the amended petition of the Trustee, Leslie S. Bowden, appearing on behalf of the Trustee, Daniel N. Stevens, Deputy Attorney General, of the State of California, appearing for the Respondents, and evidence both oral and documentary having been introduced on behalf of the parties, and after hearing the arguments of counsel, and being fully advised in the premises, and the matter having been submitted for decision, I find:

I.

That George T. Goggin, is the duly elected, acting and qualified Trustee in Bankruptcy of the above-named bankrupt.

II.

That the Trustee herein, for a limited period of time [18] in connection with the administration of this bankrupt estate conducted the business of said bankrupt, and in the course of the conduct of said business paid to the Respondents herein, all California State Sales Tax required to be paid by him in accordance with the laws of the State of California.

III.

That in liquidating the assets of this estate, the Trustee sold in open court to the highest bidders, a portion of the assets of this estate consisting of automobile trucks, and received therefor the total purchase price of Ten Thousand Eight Hundred Seventy-five ($10,875.00) Dollars. That said sales were duly confirmed by an order of this court. That said automobile trucks were not sold by the Trustee herein in the course of conducting the business of the bankrupt estate.

IV.

That subsequent to the sales of said automobile trucks the Respondents herein notified the Trustee that he had become indebted to them on account of said sales in the sum of Two Hundred Seventy-six and 24/100 ($276.24) Dollars, for California Sales Tax, calculated by them under the provisions of the California Sales Tax Act. That the Trustee refused to pay the same.

V.

That the Respondents herein have filed no claim

in this proceeding for said alleged sales tax, and are attempting to enforce the payment of said Sales Tax as against the Trustee herein.

VI.

That the Trustee is not required to pay to the Respondents herein Sales Tax on said automobile truck sales, for the [19] reason that the said sales were made by the Court in the normal administration of this estate in liquidating the assets for the benefit of the creditors.

VII.

That by reason of the facts, the Trustee has no plain, speedy and adequate remedy at law.

It Is Therefore Ordered that the Respondents herein and each of them be and they are hereby permanently restrained and enjoined from attempting in any manner whatsoever, from enforcing as against the Trustee herein or this bankrupt estate herein the payment of said sum of Two Hundred Seventy-six and 24/100 ($276.24), or from enforcing or attempting to enforce as against the Trustee herein or this bankrupt estate, any of the provisions of the California State Sales Tax in connection with the sales herein referred to.

Dated: Los Angeles, California, this 9th day of December, 1946.

HUGH L. DICKSON,
Referee. [20]

State of California,
County of Los Angeles—ss.

Daniel N. Stevens, Deputy Attorney General, being by me first duly sworn, deposes and says: That he is one of the attorneys for petitioner in the above-entitled matter; that he has heard read the foregoing Petition for Review and knows the contents thereof; and that the same is true of his own knowledge, except as to the matters which are therein stated upon information or belief, and as to those matters, that he believes it to be true.

/s/ DANIEL N. STEVENS.

Subscribed and sworn to before me this 7th day of January, 1947.

[Seal] /s/ KATHRYN BUCKMAN,
Notary Public in and for the County of Los Angeles, State of California.

Affidavit of Service by Mail attached.

[Endorsed]: Filed Jan. 7, 1947. [22]

[Title of District Court and Cause.]

REFEREE'S CERTIFICATE ON REVIEW

To the Honorable Jacob Weinberger, Judge of the United States District Sourt, Southern District of California, Central Division.

I, Hugh L. Dickson, Referee in Bankruptcy in the above-entitled matter do hereby certify:

That George T. Goggin, the Trustee herein, filed his petition for Order to Show Cause against Wm. G. Bonelli, George R. Reilly, Jas. H. Quinn, Thos. Kuchel, and Richard E. Collins, members of the State Board of Equalization of the State of California, to show cause why the State Board of Equalization should not be permannently enjoined from attempting to enforce any of the provisions of the State Sales Tax Act of the State of California against said Trustee or collect the tax referred to in said Trustee's petition.

On the 31st day of October, 1946, at the hour of 10:00 a.m. at the date of hearing of said petition, Leslie S. Bowden appeared as Attorney for the Trustee, and Robert W. Kenny, Attorney General of the State of California, Daniel E. Stevens, Deputy Attorney General, appeared for the State Board [23] of Equalization. Upon stipulation being made in open court, the Trustee was granted leave to file his amended petition. The hearing on the petition was not completed on the 31st day of October, 1946, and was regularly continued and concluded on the 14th day of November, 1946.

The question presented for determination was as follows:

"Is a Trustee in Bankruptcy Liable for the California State Sales Tax on Sales Made in Liquidation and not in the Conduct of the Business."

The Trustee contended that he was not liable as Trustee in Bankruptcy for the payment of taxes of the California State Sales Tax where property he had sold was not sold in the conduct of the business of the bankrupt, but was sold in liquidation sales.

It was the contention of the State Board of Equalization that the Trustee in Bankruptcy was liable for the payment of all taxes under said Act computed on the amount of sales of all property sold by him in this proceeding.

The facts generally were stipulated to as follows:

That the West Coast Cabinet Works, Inc., was engaged in the business of selling tangible personal property at retail in the State of California, that the Receiver, George T. Goggin, conducted the business for a limited period of time and completed certain orders which had been started by the bankrupt, and paid the state sales tax on the articles so completed. Upon being elected Trustee, he also conducted the business for a limited period of time and completed certain orders which the bankrupt had started and paid the state sales tax on the articles so completed, That as Trustee and liquidating the asset of the bankrupt he sold five (5) [24] trucks which the bankrupt had used in the operation of its business, and on said sales the State Board of Equalization made a determination against said Trustee and assessed said Trustee the sum of Two Hundred Sixty Eight and 20/100 ($268.20) Dollars. The amount claimed by it as the California State Sales Tax accruing on the sale of said trucks.

Upon considering the evidence, I found that the position of the Trustee was correct and thereupon on the 9th day of December, 1946, issued a permanent injunction restraining and enjoining said State Board of Equalization from enforcing or attempting to enforce as against the Trustee herein, or the Bankrupt Estate, any of the provisions of the Cali-

fornia State Sales Tax Act in connection with sales made in liquidation and not made in operating the business of the bankrupt. A copy of said injunction was served upon and approved as to form by the Attorneys for the State Board of Equalization as is shown in said order on file herein.

Thereafter and on the 7th day of January, 1947, the State Board of Equalization filed their petition for review of said order by the Judge.

Attached to this certificate are the following documents:

1. The petition of the State Board of Equalization for Review of Referee's Order by Judge.
2. The amended Petition for Order to Show Cause of the Trustee herein.
3. The Order to Show Cause issued by the Court on said Petition.
4. The Injunction issued on said Amended Petition on the 9th day of December, 1946, which contains proof of service thereof. [25]
5. The Reporter's Transcript of the evidence taken in the proceeding.
6. Order Extending Time to File Petition for Review.
7. Objections to Proposed Findings of Fact by State Board of Equalization.

Dated: Los Angeles, California, this 14th day of February, 1947.

/s/ HUGH L. DICKSON,
Referee in Bankruptcy.

[Endorsed]: Filed Feb. 19, 1947. [26]

[Title of District Court and Cause.]

ORDER RE AMENDMENT OF REFEREE'S CERTIFICATE

For the purpose of facilitating this Court's consideration of issues before it on the Petition of the State Board of Equalization to Review Referee's Order, and to avoid the delay incident upon the taking of further testimony before the Referee,

It Is Ordered that the testimony and exhibits mentioned in the stipulation of counsel attached hereto be considered a part of the Referee's Certificate to the same effect as if originally certified by the Referee on February 14, 1947.

Dated: February 14, 1949.

/s/ JACOB W. WEINBERGER,
Judge U. S. District Court.

[Title of District Court and Cause.]

STIPULATION

It Is Stipulated by and between counsel for the Trustee herein and counsel appearing on behalf of the California State Board of Equalization that at the hearing before the Honorable Hugh L. Dickson, Referee in Bankruptcy, on the order directing said State Board of Equalization to show cause why it should not permanently be enjoined from attempting to enforce any of the provisions of the California Sales and Use Tax Law against the Trustee

herein or to collect a Retail Sales Tax measured by the gross receipts of the Trustee from the sale by him of certain automobile trucks which were assets of the bankruptcy estate, one John J. Campbell was called to the stand as a witness on behalf of the said Board of Equalization; that said witness testified that he occupied the position of State Sales Tax Administrator, as shown by the transcript of said hearing at page 20 thereof; that from said transcript it appears that counsel for the Board of Equalization made offers of proof as follows: [28]

"Mr. Stevens: I will offer to prove by this witness if he were permitted to answer that question that he would testify the District Tax Administrators and the auditing staffs of the State Board of Equalization have been instructed to apply the sales and use tax law to a Trustee in Bankruptcy under either of two situations.

"If the auditor in making his audits finds that the Trustee has continued the business of the bankrupt retailer and subsequently has sold the retailer's merchandise and equipment in liquidation of the bankrupt's estate, the tax is applied under those circumstances to all sales whether sales of stock, goods, or of equipment used in the retail business.

"Under the other theory the auditing staff is instructed that the Trustee's sale of tangible personal property in liquidation of the bankrupt's estate must be examined to see whether they are of a character and number to constitute the Trustee a retailer within the purview of the sales and use tax law.

"In this connection the auditing staff is further instructed that if two or more sales are made in any taxable period the Trustee is to be considered a retailer within the meaning of the sales and use tax law and that if such sales are sales at retail which are sales to an ultimate consumer or for any other purpose other than resale, the Trustee is to be assessed a tax measured by the gross receipts from such sales.

"I will offer to prove by this witness that the instructions which have been adopted and the administrative practice which has been employed by the Board since the effective date of the California Retail Sales Act is to [29] regard the sales tax as applicable to gross receipts from sales of tangible personal property made by administrators and executors of probate estates in connection with the liquidation of the estates of decedents and by trustees and receivers in State courts as well as in the Federal Court, assignees for the benefit of creditors, State liquidators, such as the Building and Loan Commissioner of the State of California when that officer takes over a corporation for the purpose of liquidation and makes sales of tanglible personal property, the State Superintendent of Banks when the State Superintendent takes over a banking in stitution and makes sales of the tangible personal property belonging to the bank. Another example would be when the Insurance Commissioner takes over an insurance company for the purpose of liquidation and sells tangible personal property within the State of California as well as other fiduciaries

in connection with the liquidation of property in insolvency proceedings.

"I will offer to prove by this witness that when the entire tangible personal property of the estate is disposed of in one or two sales and the estate does not otherwise sell tangible personal property the Board's administrative practice is and has been to regard such a sale as not within the taxing province of the law for the reason that the making of one or two sales of tangible personal property is not regarded as constituting the seller a retailer as defined under Section 2(E) of the Retail Sales Act of the State of California and Section 6015 of the Revenue and Taxation Code of the State of California. It is the administrative practice where tangible personal property is disposed of by retail sales in series of more [30] than two transactions that the seller, whether he be executor, administrator, trustee, or other representative, is regarded as a retailer to the same extent as would be an individual or firm disposing of his or its own property."

(Tr. p. 24, line 20—p. 27, line 7.)

"Q. (By Mr. Stevens): How are your administrative instructions, Mr. Campbell, applicable to the facts in this case?

* * *

"Mr. Stevens: I will offer to prove by this witness in answer to that question he would testify that under either of the two theories previously mentioned in the offer of proof made in response to the question 'What are those instructions?' that in this

case the auditor finds that forty-four sales of tangible personal property have been made by the Trustee in bankruptcy; that thirty-two of such sales are retail sales, or in other words, sales to ultimate consumers or for purposes other than resale; that twelve of such sales are sales for resale and that nine of the forty-four sales are of cabinets or cupboards which were manufactured in the course of the Bankrupt's business; that under the first theory the auditor finds that the Trustee has applied for a sales tax permit to engage in the sale of tangible personal property in the State of California and that pursuant to that seller's permit the Trustee has made a number of sales of the stock in goods of the bankrupt retailer. Consequently, under the first theory, when the auditor finds that sales were made of equipment and machinery used in connection with the operation of the bankrupt's retail business the auditor applies the tax to the sale of such equipment and machinery. Under the second theory the [31] administrative instruction would be applicable because of the fact that forty-four sales were made during the period which the Trustee held a seller's permit issued by the State Board of Equalization and that thirty-two retail sales made are sufficient in number, scope, and character to constitute the Trustee a seller within the meaning of the Sales Tax Law."

(Rep. Tr. p. 32, lines 7-8; p. 32, line 15—p. 33, line 17.)

It Is Stipulated by counsel that the aforesaid wit-

ness may be deemed to have testified in accordance with and as set forth in said offers of proof.

It Is Further Stipulated that the exhibits admitted for identification and numbered Board's Exhibits 1, 2 and 3 may be deemed to have been admitted in evidence at said hearing as the Board's Exhibits 1, 2 and 3.

It Is Further Stipulated that the witness Ivan Kingman called on behalf of the California State Board of Equalization may be deemed to have testified in accordance with and as set forth in the offer of proof contained in the exhibit set forth on pages 17, 17a, 18 and 18a of the Transcript of said hearing.

Dated: February 9th, 1949.

/s/ LESLIE S. BOWDEN,
Attorney for Trustee.

FRED N. HOWSER,
Attorney General.

/s/ EDWARD SUMNER,
Deputy Attorney General, Attorneys for State Board of Equalization.

It Is So Ordered.

It Is Further Ordered that the Referee's Certificate may be amended to include this stipulation and order.

/s/ HUGH L. DICKSON,
Referee. [32]

BOARD'S EXHIBIT No. 1

State Board of Equalization

Office Correspondence

Place: Sacramento, California

Date: June 10, 1941

To: Headquarters & Field Staff, Sales Tax Division

From: T. H. Mugford

Re: Ruling 79—Final Returns—New Permits

The following procedure will be used in the situations mentioned in Ruling No. 79:

1-a. Death of an Individual Proprietor and Liquidation of His Business:

A final return is not required within fifteen days of the death of the proprietor but is required within fifteen days of the quitting of business; i.e., completion of sales in the liquidation process by the decedent's representative. A form 406 and new permit are not required if the decedent's representative is liquidating the business over a relatively short period and is not continuing the business

1-b. Death of an Individual Proprietor and Operation of His Business Continued by His Representative:

A final return is not required within fifteen days of the death of the proprietor in such

cases. Form 406 and new permit, however, are required so that the old permit in the name of the decedent will be closed out and a new permit will be issued in the name of the representative for the estate of the decedent.

The principal test by which to distinguish situation 1-a from 1-b is whether, (1-a) the representative is merely selling out the equipment and stock of goods of the decedent during a short period in the process of liquidation, or (1-b) he is continuing to operate the business, making additional purchases of merchandise, holding out that the business is a going concern, etc.

In both 1-a and 1-b, if a claim in probate is to be filed, it is necessary to show in an audit report the liability accrued prior to the death of the proprietor separately from the liability accrued thereafter.

2. Changes of Ownership Without Quitting of Business:

In situations number 2, 3 and 4 in ruling 79 where there is a change in the personnel of the partnership but not a quitting [33] of business, there is no requirement that a return be made within fifteen days from date of the change in the partnership. A form 406 to close out the old partnership and a new permit for the new partnership are required as of the date of the change in the partnership.

3. Returns Without Penalty-Accounts:

In each of the four situations mentioned in ruling 79, a return filed within the required time

for the month or quarter, as the case may be, during which the death or change in the personnel of the partnership occurred will be accepted without penalty. Such returns if they are full-paid will not be "split" between the periods before and after the change until or unless a claim, assessment or refund involving both periods is to be made.

4. Assessments and Refunds:

If in any of these four situations mentioned, an assessment or a refund is to be made for periods both prior and subsequent to the death or change in partnership, audit reports, assessment notices and refund claims must segregate the liability or over-payment between the two periods.

/s/ J.H.M.

THM:TW [34]

BOARD'S EXHIBIT No. 2

August 11, 1943

Leib & Leib
First National Bank Building
San Jose 15, California

Gentlemen:

We acknowledge your letter of August 7, with further reference to a proposed sale by the Executrix of the Estate of a deceased person of two cases and two bottles of whiskey which are a part of the Estate.

In so far as the provisions of the California Retail Sales and Use Tax Law are concerned, no tax would be due nor would any return be required if a single sale were made of all of the tangible personal property of the Estate. However, if the property were to be sold piecemeal, a number of separate sales being made, a seller's permit and return and payment of sales tax would be required.

We are referring your letter of August 7th to the Alcoholic Beverage Control Division should any question arise, in view of that division's letter to you of July 27th, concerning a possible violation of the provisions of the Alcoholic Beverage Control Act.

Very truly yours,
ASSOCIATE TAX COUNSEL.

EHS:BW [35]

BOARD'S EXHIBIT No. 3

Sales by Administrator or Executor

Sacramento, California
December 6, 1934

Hahn & Hahn,
Suite 808 Pacific Southwest Bldg.
Pasadena, California

Gentlemen:

We have your inquiry of December 3rd as to the applicability of sales tax to receipts from oriental rugs exchanged with creditors for cancellation of indebtedness to them.

Section 2b of the California Retail Sales Tax Act defines "sale" as "any transfer, exchange or barter, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration."

Accordingly, where your client, the administrator of the estate of H. D. Philibosian, exchanged oriental rugs with the creditors of the estate, the transaction was a sale, within the meaning of the Act.

The administrator succeeding to the business of the decedent is engaged in business within the meaning of the Act, and accordingly the transactions in question cannot be held to be isolated or occasional sales not subject to tax.

The sales tax should be paid on the amount of indebtedness cancelled as a consideration for the exchange of the rugs, as such is the true consideration for the sale.

We enclose a copy of the Sales Tax Act and call your attention to Section 14 thereof, to the effect that a permit is not assignable and shall be valid only for the person in whose name it is issued.

If it is the intention of your client to promptly liquidate the business, we will permit liquidation and reporting of the tax under the old permit number, but if the business is to be operated for any considerable length of time a new permit must be obtained.

We have issued sales tax rulings in loose leaf form, but we believe that reference to the provisions

of the Sales Tax Act above noted will suffice for your purpose.

Very truly yours,
R.W.B.,
Asst. Sales Tax Counsel.

RWB/L

[Endorsed]: Filed Feb. 14, 1949. [36]

OPINION

[The Opinion of Judge Weinberger, filed August 7, 1950, is reported in 92 Fed. Supp. 636.]

[Title of District Court and Cause.]

OBJECTIONS TO PROPOSED FINDINGS

Comes Now the California State Board of Equalization, by and through its counsel, Fred N. Howser, Attorney General of the State of California, and James E. Sabine and Edward Sumner, Deputy Attorneys General, and makes formal objection to the proposed findings prepared by counsel for the Trustee in Bankruptcy herein on the ground that the findings are incomplete in the following respects:

1. The findings do not disclose that the instant bankruptcy proceeding was initiated by the filing of the petition under Chapter XI on February 5, 1946, nor that adjudication thereafter occurred on March 12, 1946.

2. The findings are incomplete in that they fail to disclose that George T. Goggin acted as Receiver during the pendency of Chapter XI proceedings from February 5, 1946, to March 11, 1946, and that upon adjudication on March 12, 1946, Mr. Goggin continued as the duly authorized Trustee in Bankruptcy of the within estate.

3. The findings fail to disclose that George [127] T. Goggin, as Receiver during Chapter XI proceedings applied for and obtained a Sales Tax permit under the California Sales and Use Tax Law and that he filed returns and paid the tax due under said Law for said period.

4. The findings fail to disclose that upon adjudication Mr. Goggin, as Trustee, applied for and obtained a permit under the California Sales and Use Tax Law and thereafter filed returns for the period March 12, 1946, to May 14, 1946.

5. The findings are incomplete in that they fail to disclose that Mr. Goggin's activities as Trustee in Bankruptcy during the period March 12, 1946, to May 14, 1946 and his activities prior thereto during the pendency of proceedings under Chapter XI, February 5, 1946, to March 11, 1946, inclusive, were identical.

6. The findings fail to disclose that the returns filed by Mr. Goggin for the period March 12, 1946, to May 14, 1946, disclosed all the sales set forth in Exhibit "A" (Rep. Tr. pp. 17-18-a, inclusive) with the exception of the five sales involved in this review.

7. The findings are incomplete in that they fail to disclose that the Board of Equalization duly determined, in the manner required by the California Sales and Use Tax Law, that additional taxes were due from the Trustee with respect to the five aforesaid sales; that the Trustee failed to petition for redetermination of that liability in the manner required by the California Sales and Use Tax Law and that said determination, accordingly, became final under the California Sales and Use Tax Law.

8. The findings are incomplete in that they do not disclose the interpretation of the California Sales and Use Tax Law by the State Board of Equalization, the body charged with administering said Law, as established by the testimony of John J. Campbell and Board's Exhibits 1, 2 and 3 (see Order re amendment of Referee's Certificate).

9. The findings are incomplete in that they fail to disclose that the five vehicles involved in this review had been used by the bankrupt in the course of a business for which he was required to hold a Sales Tax permit up to the date proceedings were commenced in the Bankruptcy Court.

Objection to the proposed findings is further made on the following grounds:

1. That there is nothing in the record to support the portion of proposed Finding V to the effect that the Board of Equalization was "attempting to enforce the payment of said Sales Tax as against the Trustee herein."

2. That proposed Finding VI is inconsistent with proposed Finding III in that Finding III discloses that the Trustee sold the vehicles in question, whereas proposed Finding VI discloses that the sales were made by the Court. The record discloses that the sales were made by the Trustee.

3. Proposed Finding VII is entirely unsupported by the record and is contrary to law.

Wherefore, it is respectfully requested that the Trustee's proposed findings be amended to satisfy the [129] foregoing objections.

Respectfully submitted,
FRED N. HOWSER,
Attorney General.

JAMES E. SABINE,
Deputy Attorney General.

/s/ EDWARD SUMNER,
Deputy Attorney General, Attorneys for Calfornia State Board of Equalization.

Affidavits of Service by Mail attached.

[Endorsed]: Filed Aug. 24, 1950. [130]

[Title of District Court and Cause.]

PROPOSED FINDINGS PURSUANT TO OBJECTIONS HERETOFORE FILED

Pursuant to the Minute Order, Judge Weinberger's calendar, August 29, 1950, and the Objec-

tions to Proposed Findings heretofore filed in the within matter,

Comes Now the California State Board of Equalization by and through its counsel Fred N. Howser, Attorney General of the State of California, and James E. Sabine and Edward Sumner, Deputies Attorney General, and makes formal request for Findings as follows:

I.

That the within proceedings were initiated by the filing of a petition under Chapter XI on February 5, 1946.

II.

That the aforesaid proceedings under Chapter XI were terminated by adjudication on March 12, 1946.

III.

That George T. Goggin was duly appointed Receiver of the debtor's estate upon the commencement of proceedings under Chapter XI on February 5, 1946, and that he acted in that [133] capacity from February 5, 1946, to March 11, 1946.

IV.

That upon adjudication, as aforesaid, on March 12, 1946, George T. Goggin was duly appointed Trustee in Bankruptcy of the within estate and acted as such from that date to and including May 14, 1946.

V.

That during the pendency of proceedings under Chapter XI, George T. Goggin, as duly appointed

and acting Receiver for the estate of the debtor (presently the bankrupt), continued to conduct the business of the debtor.

VI.

That as Receiver for the debtor's estate under Chapter XI, George T. Goggin applied for and obtained a sales tax permit under the California Sales and Use Tax Law and filed returns under that Law on sales of tangible personal property at retail, and paid the tax under said Law for that period.

VII.

That upon adjudication, on March 12, 1946, George T. Goggin, as duly appointed Trustee in Bankruptcy of the within bankrupt estate applied for and obtained a permit under the California Sales and Use Tax Law, and thereafter filed returns under that Law for the period March 12, 1946, to May 14, 1946.

VIII.

That George T. Goggin's activities while acting as Trustee in Bankruptcy during the period March 12, 1946, to May 14, 1946, and his activities prior thereto while he was acting as Receiver under Chapter XI from February 5, 1946, to March 11, 1946, inclusive, were identical.

IX.

That during the period March 12, 1946, to May 14, 1946, [134] George T. Goggin, as Trustee in Bankruptcy of the within bankrupt estate, made forty-four (44) sales of tangible personal property, six (6) of which were sales for resale.

X.

That on the returns filed by George T. Goggin, as Trustee in Bankruptcy of the within bankrupt estate, for the period March 12, 1946, to May 14, 1946, he disclosed only thirty-nine (39) of the aforesaid sales, including the six (6) sales for resale, the last report sale having occurred on May 14, 1946.

XI.

That the returns filed by George T. Goggin, as Trustee in Bankruptcy of the within bankrupt estate, for the period March 12, 1946, to May 14, 1946, failed to disclose five (5) sales which took place in open court on March 29, 1946, for a total consideration of $10,875.00, said sales having been duly confirmed by an Order of this Court.

XII.

That upon audit of the returns filed by George T. Goggin, as Trustee in Bankruptcy of the within bankrupt estate, by the California State Board of Equalization, said Board duly determined in the manner required by the California Sales and Use Tax Law that additional taxes were due from said Trustee with respect to the aforesaid five (5) sales occurring on March 29, 1946, measured by the gross amounts received by said Trustee from said sales.

XIII.

That George T. Goggin, as Trustee in Bankruptcy of the within bankrupt estate, did not file a petition for redetermination of the tax liability determined to be due by the California State Board of Equaliza-

tion in connection with the five (5) sales, as aforesaid, and that said determination, accordingly, became [135] final under that Law.

XIV.

That the five (5) items sold by the Trustee in open court on March 29, 1946, consisted of five (5) vehicles which had been employed by the bankrupt immediately prior to the commencement of proceedings under the Bankruptcy Act in the course of a business for which it was required to hold a sales tax permit.

XV.

That it has been the long-continued administrative interpretation of the California Sales and Use Tax Law by the State Board of Equalization, the body charged with administering said Law, that said Law is applicable to trustees in bankruptcy who make sales of tangible personal property at retail.

XVI.

That subsequent to the Board's determination, as aforesaid, that George T. Goggin, as Trustee in Bankruptcy of the within bankrupt estate, was indebted to it under the California Sales and Use Tax Law for taxes attributable to the sales on March 29, 1946, neither the California State Board of Equalization, nor anyone in its behalf, made any effort whatsoever to enforce payment of the amount determined to be due, as aforesaid.

XVII.

That the California Sales and Use Tax Law pro-

vides a speedy and adequate remedy at law to contest the imposition of an invalid or erroneous liability under that Law.

Respectfully submitted,

FRED N. HOWSER,
Attorney General.

JAMES E. SABINE,

/s/ EDWARD SUMNER,
Deputies Attorney General, Attorneys for California State Board of Equalization.

Affidavits of Service by Mail attached.

[Endorsed]: Filed Sept. 1, 1950. [136]

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This matter having come on regularly to be heard upon the petition for the review of the Referee's Order, and the Trustee in Bankruptcy being represented by his counsel, Leslie S. Bowden, Esq., and the State Board of Equalization being represented by Fred N. Howser, Attorney General of the State of California and James E. Sabine and Daniel N. Stevens, Deputy Attorneys General, and Craig, Weller and Laugharn, Esqs. by Hubert F. Laugharn, Esq. and Thomas Tobin, Esq. having appeared as amicus curiae, and final arguments of counsel

having been made on the 6th day of December, 1949, and the matter having been submitted, the Court finds:

I.

The bankrupt herein, West Coast Cabinet Works, Inc., a corporation, was engaged in the business of manufacturing and selling cabinets and filed sales tax returns and paid [139] sales tax on sales at retail under the California Sales and Use Tax Law.

II.

On February 5, 1946, said corporation filed a petition under Chapter XI of the Bankruptcy Act, and George T. Goggin as receiver of the debtor was authorized to conduct the business of said debtor and sell the same as a going concern; as such receiver, he applied for and obtained from the Board of Equalization of the State of California a seller's permit to engage in the business of selling tangible personal property at retail and to and including March 12, 1946, and conducted the business of the bankrupt and engaged in the business of selling tangible personal property at retail, and paid sales tax on sales at retail under the California Sales and Use Tax Law.

III.

On March 12, 1946, said corporation was adjudicated a bankrupt, and George T. Goggin as the appointed trustee was authorized by order of Court to conduct the business of the bankrupt for a limited period. As such trustee, he applied for, and obtained from the Board of Equalization of the State

of California a seller's permit to engage in the business of selling tangible personal property at retail, and to and including March 22, 1946, he conducted the business of the bankrupt and engaged in the business of selling tangible personal property at retail, and paid sales tax on sales at retail under the California Sales and Use Tax Law.

IV.

On March 22, 1946, said trustee was directed by order of court to sell the assets of the estate either at public auction or private sale. Thereafter, and to and [140] including May 14, 1946, he made various sales of the assets of the bankrupt estate, and filed sales tax returns prepared by a representative of the Board of Equalization in conjunction with an employee of the trustee; during such period the trustee made approximately twenty sales at retail, and all of such sales were included on sales tax returns under which sales tax was paid excepting the sales of five trucks hereinafter mentioned.

V.

On March 29, 1946, pursuant to said order of March 22, 1946, the trustee sold at retail at public auction in open court, subject to the confirmation of court, five trucks which had been used by the bankrupt in the conduct of his business; each of said five trucks was sold to a different person; the amount of the sales tax was not included in the purchase price thereof. Said sales were confirmed by order of court. Said sales were not reported on any sales tax return.

VI.

That the Board of Equalization instructed its local officers prior to the issuance of the injunction herein that the trustee in making the sales of said five trucks as aforesaid was subject to the provisions of the Sales and Use Tax Law of the State of California and instructed said officers to apply the provisions of said Law to the trustee herein with reference to said sales.

VII.

The Board of Equalization made an additional determination of taxes due and owing from the trustee, basing said assessment upon the gross receipts from the sales of the five trucks; notice of such assessment was mailed to the trustee, no petition for redetermination was filed within [141] thirty days thereafter, and a penalty of 10% was added by the Board to the amount claimed to be due from the trustee, and the trustee has refused to pay said tax or penalty.

VIII.

That said Board of Equalization, prior to the issuance by the Referee of the injunction herein, and at the time of the issuance of said injunction was attempting to, and unless restrained will, enforce the provisions of said Law against the trustee and the bankrupt estate herein.

IX.

That during the period subsequent to the order of court directing the trustee to sell the assets of

the estate, said trustee was not authorized to conduct any business, and did not conduct any business, and did not engage in the business of selling tangible personal property, and was not a "person," or a "retailer," or a "seller" as defined in said California Sales and Use Tax Law.

X.

The trustee has no plain, speedy or efficient remedy in the courts of the State of California with reference to the matters involved herein.

From the foregoing findings of fact, the Court makes it Conclusions of Law:

I.

This Court has jurisdiction in the premises.

II.

The Referee had jurisdiction to hear and determine the matters which are the subject of this review.

III.

The trustee herein, in making the sales of the five trucks mentioned in Finding V was not subject to the provisions of the California Sales and Use Tax Law. [142]

IV.

The application of any of the provisions of the California Sales and Use Tax Law by the Board of Equalization of said State as against the trustee herein with reference to the sales of the five trucks mentioned in Finding V is contrary to said Law.

V.

The trustee has no plain, speedy or efficient remedy in the courts of the State of California with reference to the matters involved herein.

VI.

The order of the Referee in issuing the injunction herein should be approved, and the petition to review filed by the Board of Equalization of the State of California should be denied.

Dated: September 29, 1950.

/s/ JACOB WEINBERGER,
United States District Judge.

[Endorsed]: Filed Oct. 2, 1950.

In the United States District Court, Southern District of California, Central Division

No. 44,249-W, Bkcy.

In the Matter of

WEST COAST CABINET WORKS, INC.,

Debtor.

ORDER DENYING PETITION TO REVIEW

The petition of the State Board of Equalization of California for review of the Referee's order of December 9, 1946, is denied.

The order of the Referee permanently enjoining the said Board from enforcing as against the trustee

in bankruptcy or the bankrupt estate herein any of the provisions of the California Sales and Use Tax Act with reference to the sales by the trustee, on March 29, 1946, of five trucks, is approved.

Dated: September 29, 1950.

/s/ JACOB WEINBERGER,
United States District Judge.

Judgment entered Oct. 5, 1950.

[Endorsed]: Filed Oct. 2, 1950. [144]

In the District Court of the United States, Southern District of California, Central Division
No. 44,249-W

In the Matter of

WEST COAST CABINET WORKS, INC.,

Bankrupt,

HEARING ON ORDER TO SHOW CAUSE ON PETITION OF TRUSTEE ON MEMBERS OF THE STATE BOARD OF EQUALIZATION

The following is a stenographic transcript of the proceedings had in the above-entitled cause, which came on for hearing before the Honorable Hugh L. Dickson, Referee in Bankruptcy, at his courtroom, 343 Federal Building, Los Angeles, California, at ten o'clock a.m., Thursday, October 31, 1946.

Appearances:

LESLIE S. BOWDEN, ESQ.,
Appearing on behalf of the Trustee, George T. Goggin, Esq.

ROBERT W. KENNY,
Attorney General of California, and

DANIEL N. STEVENS,
Deputy Attorney General, appearing on behalf of the Board of Equalization.

The Referee: In the Matter of West Coast Cabinet Works, Inc., hearing on Order to Show Cause on Petition of Trustee on members of the State Board of Equalization, I understand Mr. Stevens, representing the State Board of Equalization, wants to make what he calls a model case for the purpose of going to the United States Supreme Court and relieve us once and for all of the question of whether or not we should pay a sales tax on a Trustee's liquidation sale. With that in mind, I am going to adopt a broad liberal attitude and let him prove everything he can.

Mr. Stevens: If the Court please, in talking with Mr. Bowden last night, Mr. Bowden learned of some facts which our records disclosed and have caused him to want a little additional time in order to present their portion of the case. I have Mr. J. J. Campbell here from Sacramento this morning. He is the Sales Tax Administrator. Mr. Bowden has

agreed that his testimony may be put on at this time.

The Referee: All right, sir, we will hear him.

Mr. Bowden: Before we start, if the Court please, at the last hearing it was stipulated that the Trustee's petition might be amended. I have here a written stipulation on the matter and if the Attorney General will sign it I will present the amended petition at this time.

Mr. Stevens: May I see the amended petition?

Mr. Bowden: It does not change the fundamental facts. [2*] I have appended a short order to the stipulation, if the Court please.

The Referee: All right, sir.

Mr. Stevens: I assume the Order to Show Cause would have been issued on the amended petition, so I am glad to stipulate with Mr. Bowden that it may be amended in that fashion.

At this time, for the purposes of this record, for review, I would like to have made a part of this record the First Report and Account of Trustee, Petition to pay expenses of administration, and Petition for dividend, filed July 17, 1946.

The Referee: All right, sir. That is a part of our official record.

Mr. Stevens: Yes, your Honor. I would like particularly to refer to that portion of paragraph 3 from which I now quote:

"That your Trustee attended various meetings in court and conferred with various and numerous persons with respect to the purchase and sale of cabinets and scrap lumber, etc., and was authorized

*** Page numbering appearing at top of page of original Reporter's Transcript of Record.**

by the court to continue the operations and to sell the incidental merchandise."

Also the portion in paragraph 6, "That your Trustee also believes that he is entitled to additional compensation for maintaining and operating the business of the Bankrupt from March 12, 1946, to on or about May 10, [3] 1946, in the amount of $604.89."

I would also like to have made a part of this record the First and Final Report and Account of Receiver, Petition to pay expenses of administration and Petition for discharge, filed also on July 17, 1946, with particular reference to that portion of paragraph 2 which reads:

"That your Receiver also went to the former plant of the debtor located at 2721 Artesia Street, North Long Beach, California and thereafter contacted various contractors who had previously given orders to the Bankrupt for the purchase of said pine kitchen cabinets; that your Receiver decided that a greater realization would be made from the assets by continuing the operations to complete the orders on hand as far as the materials were available; that your Receiver also contacted various sellers of pine lumber and was successful in arranging for a delivery of a small portion thereof which was necessary for completion of the cabinets; that your Receiver thereupon caused a skeleton force to complete the cabinets and arranged to sell the same to various purchasers; that during the operation as Receiver, and subsequently as Trustee, your peti-

tioner received from the sale of assets pursuant to his operation a sum in excess of $7000."

Also, with reference to paragraph 5 of that petition I quote:

"That your Receiver as Trustee sold merchandise, materials and other assets of the Bankrupt and is accounting in the proceedings herein as Receiver or Trustee for the total sum of $47,078.38; that your Receiver's statutory compensation on said sum is $610.78; that your Receiver also believes that he is entitled to additional compensation for maintaining and operating the business of the Bankrupt from February 5, 1946 to March 12, 1946, in the amount of $450."

I would also like to make part of this record the order of August 20, 1946, signed by Hubert F. Laugharn, Referee in Bankruptcy, approving the First Report and Account of Trustee and authorizing payment of expenses of administration. This order was the culmination of the hearing had on August 8, 1936, at ten a.m., before said Referee. In that order I would specifically like to direct the Court's attention to the fact that in addition to the Receiver's fee of $610.78 there was allowed the amount of $450 additional for operating the business and that in addition to the Trustee's fee one-half of which amounted to $302.44 and which was authorized to be paid by that order there was also a fee of $500 paid to the Trustee for operating the business.

I would also like to make part of this record the

order of sale signed by Hugh L. Dickson, Referee in Bankruptcy, dated and filed March 22, 1946.

Mr. Bowden: What does that refer to, the trucks in question? [5]

Mr. Stevens: No. This is a general order which reads: "It is hereby ordered that said Trustee be and he is hereby authorized and directed to sell all of the property of the estate of said Bankrupt of whatsoever nature and description that is or may hereafter come into his possession or control either at private sale or public auction as in the discretion of the Trustee shall be to the best interests of the estate of said Bankrupt; any sale or sales of the whole or any part thereof, at private sale, to be subject to the approval and confirmation of this Court; any sale or sales of the whole or any part thereof, at public auction, to be the sum not less than seventy-five per cent of the appraised value of such property so sold."

Mr. Bowden and I have been attempting to arrive at a stipulation of facts of which I advised Mr. Bowden last night and I think that a little additional time is going to be necessary before we can get together on that. Therefore, with the Court's permission, we would like to continue the matter for that purpose. I do have a witness here and I can go ahead with him.

The Referee: All right, let's have him. Bring him up. [6]

* * *

IVAN F. KINGMAN

called as a witness on behalf of the Board, having been first duly sworn, testified as follows:

Direct Examination

By Mr. Stevens:

Q. Will you state your full name?
A. Ivan F. Kingman.
Q. By whom are you employed?
A. The State Board of Equalization.
Q. What is your position with the Board?
A. I am field auditor.
Q. For the Sales Tax Division?
A. For the Sales Tax Division, yes, sir.
Q. How long have you been so employed?
A. Since 1935.

Mr. Bowden: If the Court please, technically I think the burden is on the Trustee to proceed under his Order to Show Cause, but I have no objection to counsel for the Attorney General's Office taking the burden for the purpose of shortening the matter.

Mr. Stevens: If you were prepared to go ahead. I understood you were not.

Mr. Bowden: Yes, but I wanted to keep the record straight as to what order we are proceeding under. Here you are proving the tax due or taking the testimony for the purpose of introducing it later on when we get into the [7] main proceeding.

Mr. Stevens: If you would be willing to stipu-

(Testimony of Ivan F. Kingman.)

late that this testimony may come in out of order.

Mr. Bowden: Let's stipulate his testimony may come in out of order subject to all objections.

Mr. Stevens: At this time? Will you make objections now?

Mr. Bowden: I will make objections now, yes.

Mr. Stevens: Fine.

Mr. Bowden: I also would like to reserve objection to the testimony in its entirety before we put in the main case.

The Referee: Let's find out what it is first.

Mr. Bowden: I am not objecting, if the Court please.

The Referee: Oh, I misunderstood.

Mr. Bowden: I am simply getting the record in shape as to the method of procedure. I am not objecting to anything at this time.

The Referee: All right. What is your next question?

Mr. Stevens: You are not going to object on the ground the original records are not here?

Mr. Bowden: No, I won't make any technical objections.

Q. (By Mr. Stevens): Now, Mr. Kingman, have you examined the books and records of George T. Goggin, the Trustee of West Coast Cabinet Works, Inc.? [8] A. Yes, I have.

Q. Have you compared those books and records with the audit report upon which the tax which is the subject of this order to show cause was based?

A. Yes, sir.

(Testimony of Ivan F. Kingman.)

Mr. Stevens: I have prepared here a schedule of sales and if we can agree that this witness will testify to these sales in the manner in which I will indicate I think we could simplify the matter greatly, Mr. Bowden.

The Referee: Am I to understand that these sales were made by the Trustee when he was operating the business? Is that your contention?

Mr. Stevens: That is the contention, your Honor, that the sales made by him were made while he was authorized so to do.

The Referee: And operated the business?

Mr. Stevens: Yes, and also the sales are of such a number so as to constitute the Trustee a retailer within the meaning of the applicable legislation.

Mr. Bowden: I will have to object to the introduction of any evidence of the Trustee's sales except those sales which are subject to the issue in this proceeding. The automobile trucks are the only issue, as to whether or not we are liable for the tax on the particular trucks. They have assessed the Trustee and the Trustee has refused to pay. I don't think we are concerned with any other sales [9] he made.

The Referee: Did they assess a tax on any other sales?

Mr. Bowden: No, only on the trucks. The taxes have been paid in the conduct of the business by the Trustee. Then when he sold these trucks he refused to pay it and the State Board of Equaliza-

(Testimony of Ivan F. Kingman.)

tion objected to it and assessed him and we are here on that matter today.

The Referee: Is that true, sir?

Mr. Stevens: No, Your Honor, it is not an accurate statement.

Mr. Bowden: I am sorry.

The Referee: What is the accurate statement?

Mr. Stevens: Mr. Goggin, both as Receiver and as Trustee, applied for a sales tax permit from the Board of Equalization and that was issued permitting him to conduct the business of selling the tangible personal property at retail in the State of California. Mr. Goggin has filed sales tax returns both as Receiver and as Trustee with the State Board of Equalization reporting both sales at retail and sales for resale which are deductible, but both of which are required to be reported on the returns. These returns were filed and the tax was remitted to the State Board of Equalization by Mr. Goggin for the amount shown by those returns to be due.

The Referee: Let me ask you right there. Are those returns he made the same items about which you propose to [10] ask this gentleman some questions? Are they the same sales?

Mr. Stevens: That is true, Your Honor.

The Referee: I don't see how that would be material. If he reported the sales and paid the tax on them, how would that be material?

Mr. Stevens: This is the reason it would be material, Your Honor, because—if I might pro-

(Testimony of Ivan F. Kingman.)

ceed with the mechanics I think I can show its materiality.

The Referee: Very well.

Mr. Stevens: The auditor goes and examines the books and records to see whether or not Mr. Goggin has reported all of the taxable sales made by him. He found that in addition to the sales reported there were the sales of these five trucks which were not reported. Therefore, the auditor considering all of the sales made during the taxable period determined that Mr. Goggin was a retailer within the meaning of the Act—he had already applied for it—and all such sales should have been returned, and because of his failure to return the sales tax on the gross receipts from the sale of these five trucks the tax was assessed against him in this proceeding. Now, unless we have the entire picture of the sales made by Mr. Goggin during the period in question it would be impossible for the Board to determine whether or not he was a retailer.

The Referee: You know he is a retailer because you granted him a license as such. [11]

Mr. Bowden: I will stipulate he did not make the return on those five trucks, if the Court please.

The Referee: But they want this gentleman to recite all of the sales on which the tax was paid. I don't think that is material. The question is: Did he as retailer sell the five trucks and is he amenable for taxes?

Mr. Bowden: That is my position, Your Honor.

Mr. Stevens: They are claiming he is not a re-

(Testimony of Ivan F. Kingman.)

tailer and therefore is not subject to the tax. Now, we have here, and our exhibit will show there were sold—this particular Bankrupt was engaged in the manufacture and sale of cabinets and cupboards.

The Referee: Yes, I remember that.

Mr. Stevens: We will show by this exhibit that Mr. Goggin as Receiver and as Trustee, in addition to selling these cabinets, sold all types of machinery and equipment which was used in that business, such as boring machines and rip saws, and various types of materials and wood products and motors.

The Referee: Did he pay a tax on them?

Mr. Stevens: He reported and paid a tax on them.

The Referee: That is as far as I am going. I am going to limit you to the question of whether or not he should pay a tax on the trucks. In other words, he has paid his score on the other things, so why put them in?

Mr. Stevens: Because it is necessary, your Honor. [12]

The Referee: It has no bearing on it. I will rule it out. Confine yourself to the contention that he should pay a tax on these trucks. That is the ruling.

Mr. Stevens: All right.

The Referee: Now, what is the next question?

Mr. Stevens: I would like to make an offer of proof at this time, if the Court please, in order to get our record in such shape that we want it.

The Referee: All right, sir, make it.

(Testimony of Ivan F. Kingman.)

Mr. Stevens: May I confer with counsel for just a moment on this question of the offer of proof?

The Referee: Yes, sir.

(A short recess was had at this point.)

Mr. Stevens: I would like to offer to prove by this witness that the books and records of the Trustee herein disclose that a sale was made on March 12, 1946, to Roy H. Alward and D. M. Townsend of scrap lumber, which sale was reported in the sale tax return of the Trustee as a sale for resale.

The Referee: And tax paid, is that true?

Mr. Stevens: There would be no tax paid on a sale for resale.

The Referee: I see. Proceed.

Mr. Stevens: That on March 12, 1946, a sale was made by the Trustee to Wilson-Cox Construction Company of cabinets in the amount of $457.74, and that that sale was [13] reported as a retail sale in the sales tax return of the Trustee filed with the State Board of Equalization and that a tax was paid in the amount so reported.

I will offer to prove that on March 12, 1946, additional cabinets were sold to Wilson-Cox Construction Company in the amount of $457.74, which sale was reported as a retail sale in the sales tax return filed by the Trustee and tax was paid upon that amount.

I will offer to prove that on March 12, 1946, a sale was made to Harry Haye of Plywood New-tone and cabinet doors in the amount of $240.04, which amount was reported in the sales tax return of the

(Testimony of Ivan F. Kingman.)

Trustee as a retail sale and the tax was paid upon that sale.

I will offer to prove on March 12, 1946, a sale was made to D. M. Townsend and Roy H. Alward of a Davis & Wells boring machine with Reuland motor, an Irvington swing saw with table, Craftsman belt sander with Peerless motor, and assorted wood-push-around hand trucks in the amount of $475, that this amount was reported in the sales tax return of the Trustee as a retail sale and the tax was paid upon that amount.

Now, rather than take up the time of the Court and go through this list item by item, I have here an exhibit which I have marked Exhibit A, which sets forth these matters item by item, the date of sale, vendee, the item, whether for retail sale or sale for resale, and whether or not under [14] the heading "Sales tax reimbursement," Mr. Goggin as Trustee added the sales tax to the amount which he charged the vendee of the merchandise sold. I will offer to prove by this witness that all of the sales were made as indicated and were reported as shown with the exception of these five items which appear on the second page of this exhibit.

The item of March 29, under "Vendee," the vendee was D. E. Krumweide, 1936 Chevrolet 6 Pick-up Truck M No. 6462026 in the amount of $405;

The item of March 29, 1946, John J. Williams, as vendee, of a 1945 Chevrolet 6 Stake Truck M. No. BG-792415 in the amount of $2500;

The item dated March 29, 1946, showing a sale

(Testimony of Ivan F. Kingman.)

to Harold Shaw on that date of a 1945 Chevrolet 6 Stake Truck M No. BG-782396 in the amount of $2,535;

The sale of March 29, 1946, to the Valley Pipe & Supply Company of a 1945 Chevrolet 6 Stake Truck M No. BG-790983 in the amount of $2,705.

Sale dated March 29, 1946, to S. Glen Hickman of a 1946 Chevrolet 6 Spec. Body Truck M No. BG-709067 in the amount of $2,725.

Those five sales were not reported by Mr. Goggin and I offer to prove by this witness that these were the five sales upon which the tax is assessed in this proceeding.

Mr. Bowden: I will so stipulate that those five sales, [15] that they are the sales on which the State Board of Equalization has assessed the Trustee for the tax under the State Sales Act and the Trustee has not paid the same and has refused to so pay. Do you accept that stipulation?

Mr. Stevens: Would you read the stipulation?

(Remarks of Mr. Bowden read by the reporter.)

I will so stipulate.

Now, in order to save going through these item by item, have you any objection to the form of my offer of proof if I make that offer by this exhibit?

Mr. Bowden: I have no objection to your using that document as your offer of proof.

Mr. Stevens: And that this witness would so testify if he were permitted to do so?

Mr. Bowden: So stipulated. [16]

EXHIBIT "A"

Date of Sale	Vendee	Item	Retail Sale	Sale for Resale	Sales Tax Reimbursement
3/12/46	Roy H. Alward & D. M. Townsend	Serap lumber		$ 75.00	
3/12/46	Wilson-Cox Const. Co.	Cabinets	$ 457.74		
3/12/46	Wilson-Cox Const. Co.	Cabinets	457.74		
3/12/46	Harry Haye	Plywood, New-tone, cabinet doors	240.04		
3/12/46	D. M. Townsend & Roy H. Alward	Davis & Wells boring machine with Reuland motor; Irvington swing saw with table; Craftsman belt sander with Peerless motor; assorted wood-push-around hand trucks	475.00		
3/12/46	Window Shade Prod. Co.	Bental Margeant 18" rip saw with G.E. 10 H.P. motor	975.00		
		American 12" sticker with G.E. 20 H.P. motor	815.00		
		24" blower with U.S. 5 H.P. motor	150.00		
3/12/46	George Gaskin	Obsolete cuts of lumber		25.00	
	Trojan Cupboard Co.	Obsolete cuts of lumber		200.00	
	Window Shade Prod. Co.	Obsolete cuts of lumber		675.00	
3/15/46	Window Shade Prod. Co.	Cupboard		5.00	
3/15/46	Gregg & Gedney	Plywood	74.50		

Exhibit "A"—(Continued)

Date of Sale	Vendee	Item	Retail Sale	Sale for Resale	Sales Tax Reimbursement
3/19/46	Harvey & Rose	Cabinets	$ 65.81		$ 1.69
3/19/46	Harold L. Shaw	11 kitchen units	1,009.30		
3/19/46	Harvey & Rose	4 upper cupboard cabinets	24.36		.60
3/19/46	D. M. Townsend & Louis Lampe	1 lot lumber; scrap pc	40.00		
3/19/46	Cash Sale	3 pc. lumber 4 x 6 x 2'	2.00		.05
3/19/46	D. E. Krumweide	Sale of lumber in bins and tables of heavy material	500.00		
3/19/46	H. E. Sawyer Cab. Works	398 pc. lumber of various sizes		557.25	
3/19/46	Southern Lumber Co.	480½ pc. lumber of various sizes		607.13	
3/22/46	D. E. Krumweide	Order nails; 13 kegs broken; 1 order hardware hinges and catches	156.00		3.90
3/22/46	Ed Dassen & Sons	1 blower and motor complete	190.00		4.75
3/22/46	Paul Johnson	1 order doors, drawers and odd pcs. lumber	150.00		3.75
3/22/46	Olins Furn. Mfg. Co.	1 set toilet equipment	12.50		.31
	Harold L. Shaw	2 shop desks and 2 bags dowels	56.75		1.40
3/22/46	Southern Lumber Co.	15 sets incomplete cabinets		425.00	
3/26/46	United Bldg. Co. of Calif.	9 cupboard cabinet units, plans B, C and D	872.61		

Exhibit "A"—(Continued)

Date of Sale	Vendee	Item	Retail Sale	Sale for Resale	Sales Tax Reimbursement
3/26/46	Ruby Hehr	21 pc. black plumbing pipe and 10 rolls roofing paper	$ 20.00		$ 0.50
3/26/46	Wilson-Cox Const. Co.	Cabinets for 1550-52 & 1600-02 Gardena St..	457.74		
3/26/46	Transit Mixed Concrete Co.	1 American 6" sticker	568.50		14.21
3/29/46	D. E. Krumweide	1936 Chev. 6 pick-up truck M. No. 6462026..	405.00		
3/29/46	John J. Williams	1945 Chev. 6 stake truck M. No. BG-792418..	2,500.00		
3/29/46	Harold Shaw	1945 Chev. 6 stake truck M. No. BG-782397..	2,535.00		
3/29/46	Valley Pipe & Supply Co.	1945 Chev. 6 stake truck M. No. BG-790983..	2,705.00		
3/29/46	S. Hlen Hickman	1946 Chev. 6 special body truck M. No. BG-709067	2,725.00		
3/29/46	Harold L. Shaw	Miscellaneous equipment	1,656.36		
4/ 1/46	Transit Mixed Concrete Co.	12,500 dowels	21.75		.53
4/16/46	D. E. Krumweide	Remington-Rand Adding Machine	210.00		5.25
4/16/46	Roy Alward	25,000 dowels		43.50	
4/16/46	Olins Furn. Mfg.	Simplex Time Clock & six time clock racks..	105.00		2.65
4/23/46	B'ilders' Control Ser., Inc.	Cabinets	205.59		
5/ 1/46	Milton J. Wershaw	Proceeds from auction sale of machinery, equipment, etc.		8,768.35	
5/14/46	Wm. H. Cochrane Co. Inc.	Cabinets for job at 1069 N. Wilson	133.60		

(Testimony of Ivan F. Kingman.)

The Referee: All right. The offer is denied on the ground I see no materiality in proving that the articles were sold and the taxes were paid. That is water over the dam. Your only contention now is that he should have paid a tax on the sale of these five trucks and he has not done so.

Mr. Stevens: That is correct.

The Referee: So the offer will be denied in so far as it applies to the transactions on which the sales were made and the tax was paid.

Anything further with this witness?

Mr. Stevens: That is all I have to ask this witness, Your Honor.

The Referee: All right, sir. Stand aside.

Mr. Stevens: I will call Mr. Campbell to the stand. [19]

JOHN J. CAMPBELL

called as a witness on behalf of the Board, having been first duly sworn, testified as follows:

Direct Examination

By Mr. Stevens:

Q. State your full name, please.
A. John J. Campbell.
Q. Where do you live, Mr. Campbell?
A. 3928 Downey Way, Sacramento.
Q. By whom are you employed?
A. The State Board of Equalization.
Q. What is your position?

(Testimony of John J. Campbell.)

A. State Sales Tax Administrator.

Q. For how long have you occupied that position? A. Since October 1, 1943.

Q. Prior to that time what was your position?

A. Prior to that, since 1936, January, 1936, to September 30, 1943, I was District Tax Administrator in the Los Angeles district. Prior to that I had been employed by the Board for twenty-four years in tax work.

Q. In your position as sales tax administrator and as district tax administrator in Los Angeles, are you familiar with the administrative practices of the Board with respect to the application of the sales tax to various factual situations?

A. I am. [20]

Q. Will you explain the scope of your duties?

A. I am at the head of the Sales Tax Division. Under my direct jurisdiction all assessments are made. Instructions are issued to the field, to the District Tax Administrators, regarding the application of the tax and in regard to accounting matters, procedure in accounting matters.

Q. Have you issued any instructions to your staff with respect to the application of sales and use tax law to sales by trustees in bankruptcy?

Mr. Bowden: Answer yes or no, please.

The Witness: Yes.

Q. (By Mr. Stevens): What are those instructions?

Mr. Bowden: Objected to as incompetent, irrelevant and immaterial.

(Testimony of John J. Campbell.)

The Referee: Are they printed instructions?

The Witness: No, Your Honor.

Mr. Bowden: I object on the further ground, if the Court please, there is no proper foundation laid.

The Referee: I don't see what materiality that has, what instructions he gives to employees. The question here is, is there a tax due on these five automobiles. The objection is sustained. I won't encumber this record with a lot of immaterial evidence.

Mr. Stevens: May I point out, Your Honor, that the Supreme Court of California in the cases of Coca Cola Company [21] versus State Board of Equalization, 25 Cal. 2d, 918, 921; Shealor versus City of Lodi, 23 Cal. 2d, 647, 653, 654; Los Angeles County versus Superior Court, 17 Cal. 2d. 707, 712.

The Referee: What do they hold?

Mr. Stevens: These cases hold that the administrative construction of a statute by the agency authorized and required to apply the tax should be accorded great weight and such interpretation will be followed by the courts unless clearly erroneous.

The Referee: I am not influenced much by that. You cannot change the Bankruptcy Law by a State law or a State rule of administration. The objection is sustained. This is a Bankruptcy Court. We are not bound by State process.

Mr. Stevens: I will offer to prove that if Mr. Campbell were asked—I just want to say this before I do that, that Your Honor has expressed on numerous occasions the desire to have this matter settled.

(Testimony of John J. Campbell.)

The Referee: I am very anxious to have it settled because every time you folks hire a new man he comes in with the same contention. It has gone to the Ninth Circuit. You say you are not bound by the Ninth Circuit decision and here you come again. I would like to see it settled finally by some authority that you gentlemen will accept, obey, and pay heed to. You say you are not bound by the Ninth Circuit. Maybe if the United States Supreme Court speaks in no uncertain terms you might pay some attention to it. [22]

Mr. Stevens: With respect to the reference to the Ninth Circuit, certain decisions have been decided which indicates the Federal Court gave an erroneous forecast of the State law in that case. We also wish if necessary to petition to the United States Supreme Court in order that a decision may be made determining the matter. In view of the fact Your Honor thinks the testimony is immaterial——

The Referee: I do.

Mr. Stevens: May I say this, that if we cannot get our evidence into the record we obviously will have to wait until we can go before another Referee who will permit the introduction of this testimony.

The Referee: All right, sir.

Mr. Stevens: We want to get all of our evidence in. It cannot affect your opinion because you deem it immaterial. I mean is there any harm done in that?

The Referee: You asked this gentleman to tell

(Testimony of John J. Campbell.)

you what instructions he gave. If you have written instructions I would be interested in seeing them. But to ask this man to repeat eight months after he gave oral instructions, what he said, is almost putting credulity to a severe test. How can he remember instructions given to someone months ago?

Mr. Stevens: They have conferences and decide on matters of policy.

The Referee: I will stand by my ruling that it is immaterial. Every taxing authority I ever had anything to [23] do with issued printed bulletins. The Internal Revenue Department and others have done it. Why these gentlemen gave it out by word of mouth I don't know.

Mr. Stevens: What was the last question?

(Record read by the reporter.)

Before I make an offer of proof in order to answer that question I think it is necessary for me to lay a foundation, if the Court please.

Q. In what manner were those instructions given?

A. They were given at conferences between the office of headquarters, between my office and the district offices, and they were given in written letters to firms of attorneys who inquired as to our position on the matter.

Q. What are those instructions? (To counsel:) You can go ahead and make your objection.

Mr. Bowden: We object on the ground it is incompetent, irrelevant and immaterial, no proper

(Testimony of John J. Campbell.)

foundation laid, not tending to prove or disprove any issue in this proceeding.

The Referee: The objection will be sustained.

Mr. Stevens: I will offer to prove by this witness if he were permitted to answer that question that he would testify the district Tax Administrators and the auditing staffs of the State Board of Equalization have been instructed to apply the sales and use tax law to a Trustee in Bankruptcy under either of two situations:

If the auditor in making his audits finds that [24] the Trustee has continued the business of the bankrupt retailer and subsequently has sold the retailer's merchandise and equipment in liquidation of the bankrupt's estate, the tax is applied under those circumstances to all sales whether sales of stock, goods, or of equipment used in the retail business.

Under the other theory the auditing staff is instructed that the Trustee's sale of tangible personal property in liquidation of the bankrupt's estate must be examined to see whether they are of a character and number to constitute the Trustee as a retailer within the purview of the sales and use tax law.

In this connection the auditing staff is further instructed that if two or more sales are made in any taxable period the Trustee is to be considered a retailer within the meaning of the sales and use tax law and that if such sales are sales at retail which are sales to an ultimate consumer or for any other

(Testimony of John J. Campbell.)

purpose other than resale, the Trustee is to be assessed a tax measured by the gross receipts from such sales.

I will offer to prove by this witness that the instructions which have been adopted and the administrative practice which has been employed by the Board since the effective date of the California Retail Sales Act is to regard the sales tax as applicable to gross receipts from sales of tangible personal property made by administrators [25] and executors of probate estates in connection with the liquidation of the estates of decedents and by trustees and receivers in State courts as well as in the Federal Court, assignees for the benefit of creditors, State liquidators, such as the Building and Loan Commissioner of the State of California when that officer takes over a corporation for the purposes of liquidation and makes sales of tangible personal property, the State Superintendent of Banks when the State Superintendent takes over a banking institution and makes sales of the tangible personal property belonging to the bank. Another example would be when the Insurance Commissioner takes over an insurance company for the purpose of liquidation and sells tangible personal property within the State of California as well as other fiduciaries in connection wih the liquidation of property in insolvency proceedings.

I will offer to prove by this witness that when the entire tangible personal property of the estate is disposed of in one or two sales and the estate

(Testimony of John J. Campbell.)

does not otherwise sell tangible personal property the Board's administrative practice is and has been to regard such a sale as not within the taxing province of the law for the reason that the making of one or two sales of tangible personal property is not regarded as constituting the seller a retailer as defined under Section 2(E) of the Retail Sales Act of the State of California and Section 6015 of the [26] Revenue and Taxation Code of the State of California. It is the administrative practice where tangible personal property is disposed of by retail sales in series of more than two transactions that the seller, whether he be an executor, administrator, trustee, or other representative, is regarded as a retailer to the same extent as would be an individual or firm disposing of his or its own property.

Q. Now, Mr. Campbell, how are your administrative instructions applicable to the facts of this case?

Mr. Bowden: We object to that on the ground it is immaterial, incompetent, and irrelevant.

The Referee: Shouldn't we dispose of the offer of proof first? Is that the end of your offer of proof?

Mr. Stevens: At that point, yes.

The Referee: I will permit the witness to say that in probate matters and in the other matters which you have mentioned that taxes have been paid, but it appears to me that Mr. Campbell's instructions are merely his interpretation of the law and I do not consider that Mr. Campbell is the

(Testimony of John J. Campbell.)

proper tribunal in which to finally determine what is the law.

Mr. Stevens: Yes.

The Referee: Therefore, the whole offer will be denied except that portion of it in which you offer to prove that in probate estates and in other matters such as banks, insurance companies, and things of that sort, [27] taxes have been levied and have been paid. I will permit him to make that statement.

Mr. Stevens: I have not asked that direct statement yet. I will ask him now.

The Referee: In your offer of proof wasn't it his instructions to levy on estates and so forth?

Mr. Stevens: Yes. Now I will ask him about it.

The Referee: As I said a moment ago, I don't think it is the function of any administrative office to determine what the law is. He can give his instructions, but they are merely his opinions. However, I will permit him to answer if such taxes have been levied and paid on probate estates and probate sales.

Mr. Stevens: I will ask that question.

Q. Has the California Sales Tax been applied and have assessments been issued with respect to sales by executors and administrators of probate estates for the purpose of liquidating the assets of the decedents?

Mr. Bowden: Objected to as immaterial.

The Referee: The objection will be overruled. I will let him answer that far.

The Witness: Yes, sir.

(Testimony of John J. Campbell.)

The Referee: Were any of them paid under protest?

The Witness: Your Honor, I have about twelve here that I picked at random when I came down.

The Referee: Did any pay under protest? [28]

The Witness: No.

Mr. Stevens: He has examples of the files in such cases.

The Referee: Many of us pay taxes under protest and then ultimately we get a refund. That happened to me once, in income tax, and I was curious whether any of them paid under protest.

The Witness: There doesn't happen to be any provision in the sales tax law for protest. They pay and then bring action to recover. They can pay under protest, that is, in the nature of filing a petition for re-determination, and if that is denied by the Board they can pay the taxes and bring action to recover taxes.

The Referee: All right.

Q. (By Mr. Stevens): Mr. Campbell, have you here in court with you some files illustrating situations where administrators have been assessed taxes in such a situation?

The Referee: I don't think that is necessary, Mr. Stevens. You have here the fact that such taxes have been levied, assessed, and paid. Now, that is sufficient.

Mr. Stevens: I agree with your Honor.

The Referee: It may be nine or nine hundred. One is plenty. All right, sir.

(Testimony of John J. Campbell.)

Q. (By Mr. Stevens): Have you also assessed taxes for sales in [29] liquidation by receivers in the State courts?

Mr. Bowden: Objected to on the ground it is immaterial.

The Referee: I will permit the answer.

The Witness: Yes, sir.

Q. (By Mr. Stevens): Do your records disclose that such taxes have been paid?

A. Yes, sir.

Q. I did not ask you that same question in connection with executors and administrators. Do your records disclose that taxes assessed in such circumstances have been paid? A. Yes, sir.

Q. And that no refund has been made of taxes in either of those two situations?

A. Not to my knowledge, no, sir.

Mr. Bowden: We object to that on the ground it is immaterial.

The Referee: I think that is going too far. Maybe the taxpayer died or got disgusted or moved away. There might be many reasons why they did not bring suit. Objection sustained to that.

Q. (By Mr. Stevens): Have you assessed the sales tax on sales by assignees for the benefit of creditors when those sales have been made for the purpose of liquidating the assets of the assignor?

Mr. Bowden: Objected to on the ground it is immaterial.

The Referee: Objection overruled. You may answer.

(Testimony of John J. Campbell.)

The Witness: Yes, sir.

Q. (By Mr. Stevens): Have such assessments been paid? A. Yes, sir.

Q. Have such assignees reported and paid sales taxes under such situations? A. Yes, sir.

Q. Have you assessed the sales tax against the Building and Loan Commissioner, the Superintendent of Banks, and the Insurance Commissioner—I am referring now to the State officers of the State of California—on sales made by those officials for the purpose of liquidating the assets of corporations taken over by those designated officials for the purpose of liquidation?

Mr. Bowden: We object to that on the ground it is immaterial.

The Referee: The same ruling; you may answer.

The Witness: I am sure we have assessed and collected taxes from the Building and Loan Commissioner. I would like to refresh my memory regarding the Insurance Commissioner and the Superintendent of Banks.

Q. (By Mr. Stevens): Has the Building and Loan Commissioner reported and paid such sales tax upon such sales? [31]

A. Yes, sir.

The Referee: In other words, all of the State agencies bow to the majesty of the State law and pay it, is that your answer?

(No answer by the witness.)

Q. (By Mr. Stevens): How are your adminis-

(Testimony of John J. Campbell.)

trative instructions, Mr. Campbell, applicable to the facts in this case?

Mr. Bowden: Objected to on the ground it has already been asked and the objection was sustained.

The Referee: Yes, sir. I won't let this gentleman usurp my functions. I get the first guess on this and then the Supreme Court of the United States will decide it if you gentlemen don't get discouraged.

Mr. Stevens: I will offer to prove by this witness in answer to that question he would testify that under either of the two theories previously mentioned in the offer of proof made in response to the question, "What are those instructions?" that in this case the auditor finds that forty-four sales of tangible personal property have been made by the Trustee in bankruptcy; that thirty-two of such sales are retail sales, or in other words, sales to ultimate consumers or for purposes other than resale; that twelve of such sales are sales for resale and that nine of the forty-four sales are of cabinets or cupboards which were manufactured in the course of the Bankrupt's business; that under [32] the first theory the auditor finds that the Trustee has applied for a sales tax permit to engage in the sale of tangible personal property in the State of California and that pursuant to that seller's permit the Trustee has made a number of sales of the stock in goods of the bankrupt retailer. Consequently, under the first theory, when the auditor finds that sales were made of equipment and machinery used in connection with the operation of the bankrupt's retail business the

(Testimony of John J. Campbell.)

auditor applies the tax to the sale of such equipment and machinery. Under the second theory the administrative instruction would be applicable because of the fact that forty-four sales were made during the period which the Trustee held a seller's permit issued by the State Board of Equalization and that thirty-two retail sales made are sufficient in number, scope, and character to constitute the Trustee a seller within the meaning of the Sales Tax Law.

The Referee: Is that the end?

Mr. Stevens: That is the end.

The Referee: The motion is denied. The testimony is denied. I will not let any witness interpret the law. I will make my ruling and then you can see who is right.

(A short recess was had at this point.)

Q. (By Mr. Stevens): Mr. Campbell, I show you a document headed "State Board of Equalization, Office Correspondence, dated June 10, [33] 1941, from Sacramento, California, to Headquarters and Field Staff, Sales Tax Division, from T. H. Mugford, re: Ruling 79, Final Returns, New Permits," and ask you if you can identify that document?

A. Yes, sir. I am familiar with this document. These instructions were sent out to the district offices regarding the procedure for filing returns in cases of administrators or anyone who was a decedent's representative, to the effect that the executor or administrator only cleared up the business and did not continue to operate the business and that he

(Testimony of John J. Campbell.)

would not be required to apply for a new sales tax permit. If, on the other hand, the executor or administrator desired to continue the business then the permit of the decedent was required to be closed out and a new permit issued to the executor or administrator covering the business that he was going to continue.

Mr. Bowden: Now, just a moment, please. I move that the last portion of the witness' answer be stricken as not responsive and on the further ground that the document he holds in his hand is the best evidence of what it is supposed to be. I did not realize that he was going to recite what is in that document.

Mr. Stevens: I think that is all.

The Referee: I think it is literally true that the document speaks for itself.

Mr. Stevens: I think it does, Your Honor. [34]

The Referee: Very well.

Mr. Stevens: I would like to offer this as an exhibit on behalf of the State Board of Equalization.

Mr. Bowden: We object on the ground it is incompetent, irrelevant and immaterial.

The Referee: I am going to sustain the objection. It is merely an interpretation of the State Board. We have here a question of law.

Mr. Stevens: May this be marked for identification, Your Honor?

The Referee: I don't see what theory an instruction given by the State officials would settle a Federal law. We all have different ideas as to what the

(Testimony of John J. Campbell.)

law is about. That is the reason I have to buy law books and that is the reason you have to buy law books—because the courts differ. These gentlemen in Sacramento have one theory and they give certain instructions. Now, whether or not that is determinative of the law, I can't see it. I will mark this for identification.

(The document was marked Board's Exhibit No. 1 for identification.)

Mr. Stevens: This administrative construction is not an attempt to apply the Federal law. It is an attempt to apply the sales tax law and they have to do that before they can apply the tax law. They have to have some instructions. [35]

The Referee: These gentlemen put certain interpretations on it and then it finally remains for the courts of the State to determine whether or not they are correct.

Mr. Stevens: Yes, Your Honor, we agree with that.

The Referee: All right, sir.

Q. (By Mr. Stevens): Have you any other written memoranda, instructions or correspondence which indicates the Board's administrative practice with respect to sales in liquidation? A. I have.

Q. What have you?

A. I have a copy of a letter written to Lieb and Lieb on August 11, 1943.

Q. From whom?

A. From E. H. Stetson, Associate Tax Counsel, State Board of Equalization, setting forth——

(Testimony of John J. Campbell.)

Mr. Bowden: Now, we object to the witness testifying from what is in the document. It speaks for itself.

The Referee: I think that is correct.

Q. (By Mr. Stevens): Is that a copy of a letter which was mailed from the Board to the firm of Lieb and Lieb in San Jose, California? A. Yes, sir.

Mr. Bowden: I won't object on the ground it is a copy. I don't want to have any technical objections here. [36]

The Referee: The courts have held it is a carbon original. That is the last pronouncement.

Mr. Bowden: Counsel can offer it.

Mr. Stevens: At this time I will offer the letter as an exhibit in support of the position of the State Board of Equalization.

Mr. Bowden: I object on the ground it is immaterial, incompetent, and irrelevant. It would not tend to prove——

The Referee: I don't know what it is yet. It might be congratulations on the birth of twins.

Mr. Bowden: I think the Court will have to read it in order to pass on the objection.

The Referee: Yes.

Mr. Stevens: I am sorry (handing document to the Referee.)

The Referee: Mr. Bowden, I think I will admit it for what it is worth. I don't think it proves anything. It says that if a man has two cases of whiskey and sells them as a whole there will be no tax. I will admit it for identification. I don't think it

(Testimony of John J. Campbell.)

has any probative value, but I will admit it for that purpose. Again, it is merely the interpretation of the State Board of Equalization.

Mr. Stevens: That is all it is offered for, merely the State Board's interpretation of the Act. That is the only purpose for the offer.

The Referee: All right, sir. [37]

(The document was marked Board's Exhibit 2 for identification.)

Q. (By Mr. Stevens): Mr. Campbell, I show you what appears to be a carbon copy of a letter to the firm of Hahn and Hahn, Suite 808 Pacific Southwest Building, Pasadena, California, signed by what appears on the carbon as R. W. B., Assistant Sales Tax Counsel, dated December 6, 1934, and ask you if you can identify this copy?

A. Yes, sir. This is a copy of a letter which was forwarded to Hahn and Hahn.

Q. On or about December 6, 1934?

A. Correct.

Mr. Stevens: I would like to offer that for the same purpose.

Mr. Bowden: We object on the ground it is incompetent, irrelevant and immaterial.

The Referee: I will admit it for identification. It may be persuasive somewhere.

(The document was marked Board's Exhibit 3 for identification.)

Mr. Stevens: That is all the questions I have of this witness.

(Testimony of John J. Campbell.)

The Referee: Any questions, Mr. Bowden?

Mr. Bowden: No questions, Your Honor.

The Referee: That is all, Mr. Campbell. [38]

(A short interruption at this point.)

Mr. Stevens: I have here a stipulation of facts which I have prepared to be signed by the State Board of Equalization by me as its attorney and the Trustee through Mr. Bowden. In our conversations last night I had understood that certain of these facts would be stipulated to. I am not prepared to prove them at this time. I think Mr. Bowden is prepared to stipulate that they are true facts, but he is not prepared to stipulate that they are material. I am just wondering, Mr. Bowden, if it would be better for me to go through these statements sentence by sentence and then if you are prepared to stipulate that they are facts, you can at that time make your objection to their materiality if you so desire.

Mr. Bowden: I will stipulate they are facts, but I will not stipulate they are competent evidence in this case.

The Referee: All right, sir.

Mr. Stevens: I have these in written form, your Honor. I think it would simplify things if I would give it to the reporter and have it copied into the record.

Mr. Bowden: We would have to have a ruling on the admissibility.

Mr. Stevens: May I give it to Your Honor to read?

The Referee: I will read it during the noon hour. Will you be back this afternoon?

Mr. Stevens: I don't think Mr. Bowden is ready to [39] proceed this afternoon.

The Referee: I will read this and reserve my ruling until you resume the hearing.

Mr. Stevens: In any event it will be stipulated those are the facts.

Mr. Bowden: Yes, it is stipulated those are the facts, but it is objected to as evidence on the ground it is incompetent, irrelevant, and immaterial, and does not prove or disprove any evidence in the case.

The Referee: You admit the statements are true?

Mr. Bowden: That is correct.

The Referee: But you deny they are pertinent?

Mr. Bowden: That is correct.

The Referee: When do you want to resume this contest?

(Discussion in re. adjournment omitted.)

(Hearing adjourned until November 14, 1946, at 10:00 a.m.)

(Following is a Stipulation of Facts referred to above and entered into between the State Board of Equalization and the Trustee herein through their respective counsel:)

"During the period from November 1, 1945, to February 5, 1946, West Coast Cabinet Works, Inc., a corporation (hereinafter referred to as the bankrupt) was engaged in the business of selling tangible personal property at retail in the State of California, under Seller's permit [40] No. AL-30146 issued

by the State Board of Equalization of the State of California (hereinafter referred to as the Board), pursuant to provisions of Sections 6066, 6067, and 6068 of the Revenue and Taxation Code of the State of California. During said period the bankrupt filed with the Board sales tax returns and reported and paid sales tax on the taxable sales so reported, pursuant to the provisions of Sections 6451, 6452, 6453 and 6454 of the Revenue and Taxation Code of the State of California.

"On February 5, 1946, the bankrupt filed a petition under Chapter 11, Section 322 of the Bankruptcy Act proposing a plan of arrangement with its creditors; on said date George T. Goggin was appointed receiver of said debtor in said proceeding. On February 26, 1946, at the first meeting of creditors, under Chapter 11, Section 322 of the Bankruptcy Act, the creditors of said bankrupt nominated George T. Goggin as trustee of the estate of said bankrupt in the event it should be necessary to administer the estate in bankruptcy, and the order of Hugh L. Dickson, Referee in Bankruptcy, was entered approving his nomination as trustee in such an event.

"In acordance with the provisions of Sections 6066 and 6067 of the Revenue and Taxation Code of the State of California, George T. Goggin, as receiver of West Coast Cabinet Works, Inc., applied to the State Board of Equalization for a seller's permit to engage in the business [41] of selling tangible personal property and was issued Seller's Permit No. AG-27329 for said purpose by

the Board, pursuant to Section 6068 of the Revenue and Taxation Code of the State of California. During the period from February 5, 1946, to and including March 11, 1946, George T. Goggin, as receiver of West Coast Cabinet Works, Inc., engaged in the business of selling tangible, personal property at retail in the State of California and filed with the Board sales tax returns and reported and paid sales tax on the taxable sales so reported pursuant to the provisions of Sections 6451, 6452, 6453 and 6454 of the Revenue and Taxation Code of the State of California.

"On March 12, 1946, West Coast Cabinet Works, Inc., was adjudicated bankrupt and George T. Goggin was appointed trustee of said bankrupt's estate.

"In accordance with the provisions of Sections 6066 and 6067 of the Revenue and Taxation Code of the State of California, George T. Goggin, as trustee of said bankrupt, applied for a seller's permit to engage in the business of selling tangible, personal property in the State of California and was issued Seller's Permit No. AG-27844 for said purpose by the Board, pursuant to Section 6068 of the Revenue and Taxation Code of the State of California. During the period from March 12, 1946, to May 1, 1946, George T. Goggin, as trustee for said bankrupt, was engaged in the sale of tangible, personal property at retail in the State of [42] California and filed with the Board, sales tax returns and reported and paid sales tax on the taxable sales so reported in said returns, pursuant to the provisions of Sections 6451, 6452, 6453 and 6454 of the

Revenue and Taxation Code of the State of California. The Board was not satisfied with said returns and, pursuant to the provisions of Section 6481 of the Revenue and Taxation Code of the State of California, the Board made an additional determination against said trustee for said period based upon information within its possession of tax in the amount of $268.20, together with interest in the sum of $8.04, for a total amount of $276.24. On or about September 13, 1946, the Board served written notice of such assessment upon said trustee by mail, pursuant to the provisions of Section 6486 of the Revenue and Taxation Code of the State of California.

"Said Trustee did not file petition for redetermination with the Board within 30 days after service upon him of said notice of determination.

"Said trustee did not pay the tax and interest assertedly due under said determination within 30 days after the service upon him of the notice thereof and, pursuant to the provisions of Section 6565 of the Revenue and Taxation Code of the State of California, the Board imposed a penalty of 10 per cent of the amount of said tax in the sum of [43] $26.82."

Thursday, November 14, 1946, 10 A.M.

The Referee: West Coast Cabinet Works, Inc.

Mr. Stevens: Ready, your Honor.

Mr. Bowden: Ready, your Honor.

Mr. Stevens: I would like to call Mr. Trezise to the stand.

GEORGE E. TREZISE

called as a witness on behalf of the Board, having been first duly sworn, testified as follows:

Direct Examination

By Mr. Stevens:

Q. Mr. Trezise, are you an officer of the West Coast Cabinet Works? A. I am.

Q. The Bankrupt in this proceeding?

A. Yes.

Q. What office? A. Secretary.

Q. Referring to the five trucks which were among the assets of the Bankrupt and which were sold by Mr. Goggin in open court on March 29, 1946, —I will identify those more particularly, now: One of them being a 1936 Chevrolet 6 Pick-up Truck M. No. 6462026; a 1945 Chevrolet 6 Stake Truck Mo. No. BG-792418; a 1945 Chevrolet 6 Stake Truck M. [44] No. BG-782397; a 1945 Chevrolet 6 Stake Truck M. No. BG-790983; and a 1946 Chevrolet 6 Special Body Truck M. No. BG-809067,—and I will ask you to state for what purpose those trucks were used in the business of the West Coast Cabinet Works, Inc.?

Mr. Bowden: I object to that on the ground it is immaterial. It does not tend to prove or disprove any issues in this case.

The Referee: I will hear it. You may answer.

The Witness: The trucks mentioned were used for the hauling from the two different plants of cabintes to various builders in Southern California

(Testimony of George E. Trezise.)

and also they were used in hauling different parts and machinery from the Long Beach plant to the Burbank plant.

Q. (By Mr. Stevens): Were they used for delivery purposes of cabinets sold by West Coast Cabinet Works, Inc.? A. That is right.

The Referee: That is, prior to bankruptcy?

The Witness: That is right.

Q. (By Mr. Stevens): Have you any knowledge of their use after bankruptcy? A. No.

Mr. Stevens: I have no further questions.

Mr. Bowden: No questions. [45]

The Referee: All right, you may stand aside.

Mr. Stevens: Is Mr. Goggin here?

Mr. Goggin: Yes, sir.

Mr. Stevens: Will you please take the stand?

GEORGE T. GOGGIN

called as a witness on behalf of the Board, having been first duly sworn, testified as follows:

Direct Examination

By Mr. Stevens:

Q. Mr. Goggin, you were first appointed receiver of the West Coast Cabinet Works, Inc., under a Chapter XI proceeding, were you not?

A. Yes, I believe so.

Q. And as Receiver you continued the business of the West Coast Cabinet Works, Inc.?

A. Well, I will explain it this way. When I took

(Testimony of George T. Goggin.)

over the plant the operations had ceased. There was on hand certain orders and contracts for manufacturing and delivering of certain wooden cabinets. In making a survey of the materials on hand we found that they could be assembled to complete a portion of the orders. The price, however, was such that it did not appear that a profit could be made if the orders were completed under the contracts made by the Bankrupt. So we contacted the contractors or purchasers in order to have the prices increased by twenty-five [46] per cent, and then we completed certain orders.

Q. You applied for a sales tax permit from the State Board of Equalization, a Seller's Permit, did you not? A. Yes, sir.

Q. And you secured such a permit, is that right?

A. Yes, sir.

Q. And you filed with the State Board of Equalization a return showing taxable sales and sales for resale which were made during the period of your operation as Receiver?

A. Yes. Now, with respect to those returns, they were prepared by the representative of the State Board of Equalization. I believe it was Mr. Lilly, in connection with Mr. Butcher.

Q. Who is Mr. Butcher?

A. He was an agent of mine; he was employed by me. Those returns were submitted and I signed the same and paid the tax in relation thereto. However, one statement was rendered which incorporated a sale of certain automobiles or trucks which I sold in open court in the liquidation of the assets,

(Testimony of George T. Goggin.)

and I refused to sign that return. Accordingly, it was modified and those items were removed from the return and that final return was signed by me.

Q. The sale of those trucks was not, however, made by you during your operation as Receiver?

A. No.

Q. I am asking you about your operation as Receiver. [47]

A. They are both tied in together and it is hard to distinguish between the two administrations.

Q. You were appointed Trustee and took office as of March 12?

Mr. Bowden: No, not Trustee.

Mr. Stevens: March 12, 1946.

Mr. Bowden: What was the date of the appointment of the Receiver?

Mr. Stevens: Of the Receiver?

Mr. Bowden: Yes.

Mr. Stevens: February 5, 1946.

Mr. Goggin: Well, I don't have the dates before me. If you say that is the date, I guess it is.

Mr. Stevens: Those are the dates according to my notes, at least.

The Referee: February 5, 1946, you were appointed Receiver. The first meeting of creditors was February 26—no. You were appointed Trustee in the event of liquidation. On March 12 there was an order of adjudication entered. Mr. Goggin became Trustee and filed his bond on March 12, 1946.

Q. (By Mr. Stevens): After you became Trustee of the West Coast Cabinet Works, Inc., you con-

(Testimony of George T. Goggin.)

tinued your operation of the business to the extent described by you, did you not?

A. That is correct. [48]

Q. And you again applied for a Sales Tax Permit from the State Board of Equalization?

A. As Trustee?

Q. As Trustee.

A. I don't recall, but probably so.

Mr. Bowden: Is that a fact? Do you know whether or not he did?

Mr. Stevens: Yes, he did apply. We have a copy of a signed application.

The Witness: At least I made a return as Trustee.

Mr. Stevens: As a matter of fact, you were issued a permit as Trustee, is that not correct?

The Witness: I believe that is correct.

Q. (By Mr. Stevens): I am going to show you one of the Board's copies and see if this will refresh your recollection of the facts as they existed at that time. A. Yes, I signed that.

Q. And you do now recall you were also issued a permit for the purpose of making sales under the Retail Sales Act of the State of California?

A. Yes, sir.

Q. And you filed a return under the Sales and Use Tax law reporting certain of your sales as taxable sales and certain of your sales as sales for resale, the gross receipts from which would not be subject to the tax? [49]

(Testimony of George T. Goggin.)

A. Yes, as the same were prepared again by Mr. Lilly of your office and Mr. Butcher.

Q. And signed by you?

A. And signed by me.

Q. During the period of your operation of the business on March 29, 1946, you sold the five trucks——

Mr. Bowden: Just a minute. Are you through?

Mr. Stevens: No.

Mr. Bowden: Oh. Don't answer, Mr. Goggin, until I make my objection.

Q. (By Mr. Stevens): On March 29, 1946, you sold five trucks which were part of the assets of the West Coast Cabinet Works, Inc.?

Mr. Bowden: Mr. Reporter, will you read that question. (Question read as above recorded.) Part of the question before that, I believe, he started out, during the operation of the business. (Previous question read.)

We object on the ground it is leading and suggestive and assumes a point not in issue, if the Court please.

The Referee: I think he is trying to elicit the facts.

Mr. Bowden: He said during the operation of the business he sold these trucks. That is for the Court to find.

Q. (By the Referee): Mr. Goggin, were you operating this business after [50] you became Trustee?

A. I think, Your Honor, just for a short time,

(Testimony of George T. Goggin.)

maybe a week or two in completing the buiiding of two or three kitchen cabinets.

Q. Were you operating the business on the date you sold these five trucks?

A. I doubt it. I don't think there was any actual operation. The mechanical part of assembling the wooden cabinets and the use of hammers and nails, I think, ceased prior to the time I sold the trucks.

Now, the sale of the trucks was had in this manner. According to the rules of court, I advertised the sale in the Los Angeles Daily Journal five days prior to this sale in open court. The matter came up for hearing and there were competitive bids and the trucks were sold to various persons who were the highest and best bidders for the equipment. I filed a petition and obtained an order confirming the sale of those items. They were not sold as part of my operations of the business as such, but were sold in the liquidation of the assets.

Mr. Stevens: I move to strike the last statement.

The Referee: It is a conclusion. It will go out, and I will draw the first conclusion and see whether or not I am right if it goes up.

Q. (By Mr. Stevens): In order to refresh your recollection, Mr. Goggin, [51] I would like to call your attention to reports filed by you in this proceeding for the period during which you operated this business.

The Referee: Here are the files.

Q. (By Mr. Stevens): Calling your attention to the First Report and Account of Trustee, Petition

(Testimony of George T. Goggin.)

to Pay Expenses of Administration and Petition for Dividend, which was filed on July 17, 1946, in this proceeding, I refer to the statement beginning on line 29 of page 1 of that report, in which you say:

"That your Trustee caused the inventory to be completed of all the machinery, equipment, office furniture, fixtures, and other incidentals."

A. What page is that on?

Q. Page 1, paragraph 3. A. Yes, sir.

Q. "That your Trustee attended various meetings in court, conferred with numerous persons with respect to the purchase and sale of cabinets and scrap lumber, etc., and was authorized by the Court to continue the operation and to sell the incidental merchandise; that your Trustee advertised certain of the office furniture and woodworking equipment and miscellaneous machinery for sale which was inventoried at prices at approximately $7,959.75; that the said matter came up for hearing and the highest and best offer received therefor was the sum of $5,600; that the [52] Court confirmed the said sale. However, your Trustee conferred with the purchasers thereof who were speculators and auctioneers and arranged for an auction of said property rather than having the sale confirmed; . . . that your Trustee also conducted a sale of certain trucks which amounted to a sum in excess of $10,000." You attach to your report Exhibit A showing receipts and in which you itemize the sales of cupboard cabinets, scrap pieces of lumber, kegs of nails, handles, hardware, and catches, a blower, and

(Testimony of George T. Goggin.)

a motor, a set of tile equipment, and two shop desks.

Mr. Bowden: What page are you reading from, Mr. Stevens?

Mr. Stevens: Most of those items were taken from page 2 of Exhibit A, and on page 3 of Exhibit A is reported a sale of plumbing pipe, roofing paper——

The Referee: Weren't all of those items tax paid, Mr. Stevens?

Mr. Stevens: Practically all of those were——

The Referee: Then why devote so much time to them if taxes were paid? Why not get down to the five trucks?

Mr. Stevens: I just want to refresh Mr. Goggin's recollection to see if this serves to refresh it as to the period in which he continued the operation of this business.

Q. Mr. Goggin, in view of these facts contained in your petition I will now ask you whether or not you did [53] not, as a matter of fact, continue the operation of the business of the Bankrupt subsequent to April 29, 1946?

A. April 29, is that the question?

Q. After March 29, 1946.

A. On April 23 I completed the sale to Builders' Control Service of certain cabinets for $205.59. Also on May 14 I completed a sale to Wm. H. Cochrane Company of certain cabinets for $133.60. Those are the only two jobs that were completed after the date that you have mentioned.

Q. You made a statement earlier this morning

(Testimony of George T. Goggin.)

that you made the sales of these trucks in liquidation of the business of the Bankrupt. How do you distinguish these sales from the sales of the motor and blower which you sold on March 12, 1946, to Window Shade Products Company?

Mr. Bowden: We object on the ground it calls for a conclusion. He is not required to distinguish.

The Referee: Objection sustained. I think that is an invasion perhaps of the province of the Court. Let me have the facts and I will draw the conclusions.

Q. (By Mr. Stevens): Did you not sell on March 12, 1946, to D. M. Townsend and Roy H. Alward a Davis and Wells spindle boring machine——

A. What was that date, Mr. Stevens?

Q. March 12, 1946.

A. What item was that? [54]

Q. A Davis and Wells boring machine with a Reuland motor. A. Yes.

Q. And to the same parties you sold an Irvington swing saw with table? A. Yes.

Q. And a Craftsman belt sander with Peerless motor? A. Yes, sir.

Q. And assorted wood-push-around hand trucks?

A. Yes, sir.

Q. You reported that sale in your return as a retail sale and paid a tax measured by the gross receipts from that sale? A. That item——

Q. Will you please answer yes or no and then explain it?

A. Yes, I probably did. If it is down on the

(Testimony of George T. Goggin.)

report, which I assume it has been, that that item was reported by your Mr. Lilly and submitted to me for signature, and I did not check the items.

I believe personally that there should not have been a tax paid upon the sale of any capital assets, and that was a capital asset.

Q. Our auditor went over the books with your Mr. Butcher, did he not?

A. Apparently so. [55]

Q. Also, on March 12, 1946, did you not sell to Window Shade Products Company a Bental Margeant 18" rip saw with General Electric 10 H. P. motor? A. Yes, sir.

Q. And to the same company on that date did you not sell an American 12" sticker with a General Electric 20 H.P. motor? A. Yes, sir.

Q. And to the same party on the same date a 24" Blower with U.S. 5 H.P. motor? A. Yes, sir.

Q. With respect to those sales did you not report them as retail sales in your sales tax return filed with the State Board of Equalization and pay a sales tax measured by the gross receipts from those sales?

A. I don't have the return, but if you say so, apparently I did.

Again with the understanding that this report was also prepared by Mr. Lilly of your office and I signed the same, and I believe also that any tax paid on that item was paid in error and should be returned, it being a capital asset.

Mr. Stevens: I move to strike that.

The Referee: It will go out, sir. I will conclude

(Testimony of George T. Goggin.)

whether or not that is right or wrong. Don't worry about conclusions from these witnesses. I will take care of them. [56] I know a conclusion from a statement after forty years of practice. All right, sir, what is the next question?

Q. (By Mr. Stevens): On March 15, 1946, did you make a sale of Plywood to Gregg and Gedney in the amount of $74.50? A. Yes, sir.

Q. And did you report that sale as a retail sale in your sales tax return filed with the State Board of Equalization and pay the tax measured by the gross receipts from that sale?

A. Apparently so. And I will make the same explanation with respect to that item as I did on the others.

Q. On March 19, 1946, did you sell one lot of lumber, scrap pieces, to D. M. Townsend and Louis Lampe in the amount of $40? A. Yes, sir.

Q. Did you report that sale in your sales tax return filed by you as Trustee with the State Board of Equalization and pay the tax measured by the gross receipts from that sale?

A. Apparently so, and again with the same explanation as in the previous answer.

Mr. Bowden: I don't like to limit this examination, if the Court please, but I think we are wasting time. Counsel is reading from the report of the Trustee which shows what he did. What difference would it make how many [57] taxes he paid. The question is does he have a liability for this particular tax. His conduct in connection with the State

(Testimony of George T. Goggin.)

Board of Equalization in filing his return would have no bearing on his liability for the tax.

Q. (By Mr. Stevens): I think I can hurry it up in this fashion. With respect to the sale of everything other than tangible personal property, other than cupboards reported by you in your report as Trustee and returned by you in your sales tax return——

Wait a minute. I got the answer in there before I finished asking my question.

Will you not admit, Mr. Goggin, that you made those returns and reported them in your sales tax return for the period in which you were Trustee with the exception of the five trucks which were sold on March 29, 1946?

Mr. Bowden: Do you understand the question, Mr. Goggin?

The Witness: Yes.

Mr. Bowden: Well, I don't. I just wondered if you did.

The Witness: With the exception of the trucks and with the exception of the sale conducted at public auction by Milton Wershow, for which he received $8,768.35, I believe the answer would be yes.

Q. (By Mr. Stevens): As a matter of fact, Mr. Goggin, you did report in your return the sales to Mr. Wershow as sales for resale which were not subject to the tax? [58]

A. I believe that is correct.

Mr. Stevens: That is all.

(Testimony of George T. Goggin.)

Cross-Examination

By Mr. Bowden:

Q. Regarding these five trucks that we have been talking about, state what you did prior to selling same and up to the conclusion and confirmation of the sale by the Court?

A. I was appointed Receiver and took over the physical assets of the Bankrupt, which consisted of various machinery and equipment, together with these certain trucks. The trucks were not used and were stored during my administration, both as Receiver and as Trustee. After the order of adjudication was entered and I was appointed Trustee, the trucks together with the other capital assets were inventoried and the inventory was filed with the Court. The Court appointed an appraiser and the same were appraised. I then advertised in the Los Angeles Daily Journal the sale of the said trucks, that the sale would be conducted in open court before Referee Dickson and would be sold to the highest bidder subject to the approval of the Court; that at the time of the return or on the return date I announced the sale and sold the trucks separately. There was competitive bidding and they were sold to the highest bidder. I then prepared a petition and return of sale and I obtained a [59] court order confirming the same and delivery of the trucks was made upon receipt of the purchase price.

Q. To the parties who were the highest bidders in court at the time of the sale, is that correct?

(Testimony of George T. Goggin.)

A. That is correct.

Mr. Bowden: That is all.

Redirect Examination

By Mr. Stevens:

Q. You did file your returns as Trustee for the period from March 12, 1946, to and including April 30, 1946, did you not, Mr. Goggin?

A. Isn't it beyond that date? Yes, I did, up to that date, at least.

Q. As a matter of fact, you have received a fee from this Court, approved by the Referee, for operating the business, in the amount of $500, is that right?

Mr. Bowden: Objected to on the ground it is immaterial.

The Referee: The record speaks for itself. You have it right before you. I take cognizance of all of my official files. The objection is sustained.

Q. (By Mr. Stevens): Can you give us the figure, the total amount received by you from the sale only of cabinets?

Mr. Bowden: I object on the ground it is immaterial.

The Referee: Objection sustained. He has paid the taxes [60] on those sales and I am not going to go any further into the matter. Confine yourself to the trucks. That is what you are fighting about.

Mr. Stevens: That is all.

Mr. Bowden: That is all.

The Referee: I find there is no liability for sales tax on these trucks.

Mr. Bowden: Before the Court rules, I have one stipulation I would like to have in the record, please.

The Referee: What is it?

Mr. Bowden: Mr. Stevens, will you stipulate the State Board of Equalization has not filed a claim in this proceeding for the tax claimed due under the sale of these five trucks?

Mr. Stevens: Yes, I will so stipulate.

The Referee: All right, sir. The ruling will be there is no tax liability here. You may draw findings to that effect.

Mr. Bowden: And the injunction will be issued, if the Court please?

The Referee: Yes, sir.

Mr. Bowden: I will prepare the order. [61]

State of California,
County of Los Angeles—ss.

I, Byron Oyler, Official Court Reporter, hereby certify that the foregoing pages comprise a true and correct transcript of the testimony given in the above entitled matter.

Dated this 20th day of November, 1946.

/s/ BYRON OYLER,
Official Court Reporter.

[Endorsed]: Filed Nov. 1, 1950 U.S.C.A.

CLERK'S CERTIFICATE

United States of America
Southern District of California—ss.

I, Edmund L. Smith, Clerk of the United States District Court for the Southern District of California, do hereby certify that the foregoing is a full, true, and correct copy of Order to Show Cause; Stipulation and Order; Amended Petition for Order to Show Cause; Injunction; Petition of State Board of Equalization for Review of Referee's Order by Judge; Referee's Certificate on Review; Order re Amendment of Referee's Certificate; Stipulation and Board's Exhibits 1, 2 and 3; Opinion; Objections to Proposed Findings; Proposed Findings Pursuant to Objections Heretofore Filed; Findings of Fact and Conclusions of Law and Order Denying Petition to Review, all in the Matter of West Coast Cabinet Works, Inc., Debtor, No. 44249-W-Bankruptcy, as the same appears from the original record remaining in my office.

Witness my hand and seal of said Court, this 17th day of October, A.D. 1950.

EDMUND L. SMITH,
Clerk.

[Seal] By /s/ THEODORE HOCKE,
Deputy Clerk.

[Endorsed]: No. 12727. United States Court of Appeals for the Ninth Circuit. California State Board of Equalization, Appellant, vs. George T. Goggin, Trustee in Bankruptcy of the Estate of West Coast Cabinet Works, Inc., Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed: November 1, 1950.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

[Title of Court of Appeals and Cause.]

ORDER GRANTING PETITION FOR ALLOWANCE OF APPEAL

The California State Board of Equalization petitions, pursuant to Section 24(a) of the Bankruptcy Act, 11 U.S.C. §47(a), for the allowance of an appeal from an order of the United States District Court for the Southern District of California, Central Division, entered on October 5, 1950, denying the Board's petition for review of an order entered by the referee enjoining the Board from enforcing provisions of the California Sales and Use

Tax Law with reference to sales of five trucks by the trustee in bankruptcy.

The petition is granted and the appeal is allowed.

WILLIAM DENMAN,
Chief Judge.

WALTER L. POPE,
Circuit Judge.

[Endorsed]: Filed Nov. 21, 1950.
PAUL P. O'BRIEN,
Clerk.

In the United States Court of Appeals
for the Ninth Circuit
No. 12727

CALIFORNIA STATE BOARD OF EQUALIZATION,

Petitioner,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of WEST COAST CABINET WORKS, INC.,

Respondent.

PETITION FOR LEAVE TO APPEAL UNDER SECTION 24(a) OF THE BANKRUPTCY ACT

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Petition of the California State Board of Equalization respectfully represents:

1. That on the 5th day of October, 1950, an Order was entered by the Honorable Jacob Weinberger, one of the Judges of the United States District Court, for the Southern District of California, in a certain proceeding in bankruptcy wherein the California State Board of Equalization was petitioner for review of an Order made and entered by the Honorable Hugh L. Dickson, Referee in Bankruptcy, and wherein George T. Goggin, Trustee in Bankruptcy of the Estate of West Coast Cabinet Works, Inc., was respondent. The said Order of October 5, 1950, denied the Petition of the California State Board of Equalization for review of the Order entered by the Honorable Hugh L. Dickson, Referee in Bakruptcy, on the 9th day of December, 1946, permanently enjoining the California State Board of Equalization from enforcing against the trustee in bankruptcy or the bankrupt estate herein any of the provisions of the California Sales and Use Tax Law with reference to sales of five trucks by said trustee on March 29, 1946. (C. T. 144.)

2. West Coast Cabinet Works, Inc., a corporation, was formerly engaged in the business of manufacturing and selling cabinets. Prior to the commencement of proceedings in the Bankruptcy Court, that corporation filed the returns and paid the tax required by the California Sales and Use Tax Law. On February 5, 1946, the corporation

filed a petition under Chapter XI of the Bankruptcy Act, and George T. Goggin was appointed receiver and authorized to conduct the corporation's business and to sell the same as a going concern. As such receiver, Mr. Goggin applied to the California State Board of Equalization (the State agency charged with the administration and enforcement of the provisions of the California Sales and Use Tax Law) for a seller's permit to engage in the business of selling tangible personal property, and the permit was duly issued to him. On March 12, 1946, West Coast Cabinet Works, Inc., was adjudicated bankrupt and George T. Goggin was authorized to continue his conduct of the corporation's business as trustee in bankruptcy. In this latter capacity Mr. Goggin again applied for and obtained a permit to engage in the business of selling tangible personal property.

Subsequent to Mr. Goggin's appointment as trustee in bankruptcy, on March 12, 1946, and to and including May 14, 1946, Mr. Goggin made numerous sales of tangible personal property. Most of these sales were retail sales, although some of them were sales for resale (R. T. 17-18a), and, with the exception of five sales on March 29, 1946, were duly reported by Mr. Goggin on returns filed with the California State Board of Equalization under the California Sales and Use Tax Law. (R. T. 15, 18.) It is to be noted that Mr. Goggin manufactured and sold cabinets (a continuation of the business of the bankrupt) as late as May 14, 1946 (R. T.

18a), although it appears that an Order was made by the Referee on March 22, 1946, directing Mr. Goggin to sell the assets of the bankrupt estate either at public auction or private sale. (C. T. 39.)

3. On or about October 3, 1946, Mr. Goggin filed a Petition for an Order to Show Cause directed to the California State Board of Equalization. This petition was amended pursuant to stipulation of counsel dated November 31, 1946 (apparently October 31, 1946—C. T. 3; R. T. 2), the amended petition praying for the issuance of an Order directing the State Board of Equalization to appear and show cause why it should not be permanently restrained and enjoined from attempting to enforce any of the provisions of the California Sales and Use Tax Law or rules and regulations relating thereto, against Mr. Goggin, the trustee, in connection with the aforesaid five unreported sales made on March 29, 1946. It is clear from the amended Petition for Order to Show Cause that the sales on March 29, 1946, consisted of sales in open court of five automotive vehicles and that the total selling price amounted to $10,875.00; that on or about September 11, 1946, the California State Board of Equalization duly determinated, in the manner provided for by the California Sales and Use Tax Law, that the trustee herein was indebted to it in the sum of $276.24 in connection with the aforementioned sales on March 29, 1946; and that included in said determination was the ten per cent penalty provided for by the

California Sales and Use Tax Law for failure to report sales made. (C. T. 5, 6.) It is clear that notice of the aforesaid determination was duly mailed to the trustee herein as provided for by the California Sales and Use Tax Law; that the determination (assessment) became final, no petition for redetermination having been filed as provided for by the California Sales and Use Tax Law; and that no claim was filed with this Court by the California State Board of Equalization relating to the aforesaid tax determination. (C. T. 6, 10; R. T. 61.)

Paragraph 5 of the amended Petition for Order to Show Cause merely discloses the trustee's belief that neither he nor the bankrupt estate are required to comply with the California Sales and Use Tax Law insofar as the aforesaid sales on March 29, 1946, are concerned, and paragraph 6 contains merely the bald assertion that unless an injunction is issued enjoining the California State Board of Equalization from attempting to collect any tax in connection with the aforesaid sales of March 29, 1946, the California State Board of Equalization will continue to assess penalties against the trustee herein and will endeavor to enforce all of the penal provisions against him as provided for by the California Sales and Use Tax Law. (R. T. 6.) It should be noted at this point that reference to the entire record herein, namely, the Reporter's and Clerk's transcripts, fails to disclose any evidence whatsoever that the Board had, would have, or intended to enforce penal provisions against the trustee herein, or that the Board would in any way have

interfered with the administration of the instant estate or the trustee's possession of the assets of the estate.

4. The Order to Show Cause signed by the Referee on October 3, 1946, ordered the various members of the California State Board of Equalization to appear before him on October 24, 1946, and then and there show cause why a permanent injunction should not be issued against them enjoining and restraining them, and each of them, from enforcing any of the provisions of the California Sales and Use Tax Law against the trustee herein, and further ordering that the Order to Show Cause might be served by deposit in the mail. (C. T. 1.)

5. On October 31, 1946, and November 14, 1946, trustee's aforesaid amended Petition duly came on for hearing before the Honorable Hugh L. Dickson, Referee in Bankruptcy, to whom the said bankruptcy proceeding had been duly referred, and on December 9, 1946, the said Referee entered an Order granting the prayer of said amended Petition. (C. T. 9-11.) The Court's attention is again directed to the Referee's finding that the California State Board of Equalization had filed no claim in the bankruptcy proceeding for the taxes in question. (C. T. 10.)

6. Thereafter, on or about January 7, 1947, the California State Board of Equalization duly filed its Petition for Review of the said Order of the Referee and its Petition came on for hearing on

the certificate of the Referee filed in said District Court on or about February 19, 1947. Upon said hearing, the said Judge of said District Court, on the 5th day of October, 1950, entered an Order dismissing said Petition for Review and confirming the Order entered by the Referee.

7. The Order of the Honorable Jacob Weinberger, Judge of the District Court, entered October 5, 1950, denying the Petition of the California State Board of Equalization for review of the Referee's Order of December 9, 1946, is erroneous in numerous respects and predicated upon a factual situation not in accord with the record herein, as evidenced by the Opinion filed August 7, 1950 (C. T. 37-126), and the Findings of Fact filed October 2, 1950. (C. T. 139-142.)

The errors complained of may be briefly summarized as follows:

a. Neither the Referee nor the District Court had jurisdiction to enjoin the enforcement of a valid State taxing statute;

b. The Findings (C. T. 139-140) are not supported by the record as more fully set forth in the accompanying brief;

c. The District Judge erroneously construed the California Sales and Use Tax Law;

d. The District Court Judge erroneously concluded that the trustee had no plain, speedy or efficient remedy in the courts of the State of California to dispute the legality and/or validity of the tax assessed against him under

the California Sales and Use Tax Law with respect to liquidation sales made by him;

e. The District Judge erroneously concluded that the California Sales and Use Tax Law does not apply to liquidation sales made by a trustee in bankruptcy even if the California Sales and Use Tax Law is applicable to trustees in bankruptcy.

* * *

Wherefore, your petitioner prays for leave to take an appeal from the said Order entered by the Honorable Jacob Weinberger, Judge of the United States District Court for the Southern District of California, Central Division, on October 5, 1950.

CALIFORNIA STATE BOARD
OF EQUALIZATION,
FRED N. HOWSER,
Attorney General.

JAMES E. SABINE,
Deputy Attorney General.

/s/ EDWARD SUMNER,
Deputy Attorney General, Attorneys for California State Board of Equalization.

Affidavit of Service by Mail attached.

[Endorsed]: Filed Nov. 1, 1950.

[Title of Court of Appeals and Cause.]

STATEMENT OF POINTS UPON WHICH APPELLANT INTENDS TO RELY

Appellant, California State Board of Equalization, intends to rely on appeal on the following points:

1. The proceedings below amounted to a suit against the State of California without its consent and in violation of the constitutional principle barring such suits;

2. Neither the Referee, who issued the Order to Show Cause commencing the proceedings resulting in the Order appealed from, nor the District Court Judge who made said Order had jurisdiction to enjoin a State taxing agency, the appellant herein, from enforcing a valid State taxing statute against respondent;

3. The Findings made by the District Judge are not supported by the record;

4. The District Judge erroneously construed the California Sales and Use Tax Law;

5. The District Judge erroneously concluded and held that appellee had no plain, speedy or efficient remedy in the court in the State of California to dispute the legality and/or validity of any tax assessed against him under the California Sales and Use Tax Law with respect to sales of tangible personal property made by him in liquidation of the within bankrupt estate;

6. The District Judge erroneously concluded and held that the California Sales and Use Tax Law does not purport to apply to a trustee in bankruptcy making sales of tangible personal property in liquidation of a bankrupt estate;

7. The District Judge erroneously concluded and held that, even if the California Sales and Use Tax Law does purport to apply to a trustee in bankruptcy making sales of tangible personal property in liquidation of a bankrupt estate, the trustee is nevertheless not subject to the California Sales and Use Tax Law by virtue of his status as an officer of the Bankruptcy Court;

8. The action of the District Judge in approving the Order of the Referee enjoining appellant from enforcing the provisions of the California Sales and Use Tax Law against appellee was erroneous and contrary to law;

9. The Decision and Order of the District Judge are predicated upon a factual situation differing substantially from the facts established by the record herein. On the facts as established by the record, appellee was clearly subject to all valid State taxing statutes, including the California Sales and Use Tax Law.

Dated: November 29, 1950.

FRED N. HOWSER,
Attorney General.

JAMES E. SABINE,
Deputy Attorney General.

/s/ EDWARD SUMNER,
Deputy Attorney General.

Attorneys for California State Board of Equalization.

Affidavit of Service by Mail attached.

[Endorsed]: Filed Dec. 1, 1950.

[Title of Court of Appeals and Cause.]

APPELLANT'S DESIGNATION OF RECORD TO BE PRINTED

Appellant, California State Board of Equalization, hereby designates all the documents (photostated documents certified by the Clerk of the District Court, and Reporter's Transcript) heretofore transmitted to this Court with the Petition for allowance of the within appeal as material to the consideration of said appeal, and hereby requests that said documents comprising the entire record of all the proceedings herein be printed as such.

Dated: November 29, 1950.

FRED N. HOWSER,
Attorney General.
JAMES E. SABINE,
Deputy Attorney General.

/s/ EDWARD SUMNER,
Deputy Attorney General.
Attorneys for California State Board of Equalization.

Affidavit of Service by Mail attached.

[Endorsed]: Filed Dec. 1, 1950.

No. 12727

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CALIFORNIA STATE BOARD OF EQUALIZATION,

Appellant,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of West Coast Cabinet Works, Inc.,

Appellee.

APPELLANT'S OPENING BRIEF.

EDMUND G. BROWN,
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Parker & Company, Law Printers, Los Angeles. Phone MA. 6-9171.

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

California State Board of Equalization,

Appellant,

vs.

George T. Goggin, Trustee in Bankruptcy of the Estate of West Coast Cabinet Works, Inc.,

Appellee.

APPELLANT'S OPENING BRIEF.

Preliminary Jurisdictional Statement.

The within appeal is taken pursuant to an Order of this Court filed November 21, 1950 [Tr. 107-108] upon appellant's petition pursuant to Section 24(a) of the Bankruptcy Act, 11 U. S. C., Section 47(a), for the allowance of an appeal from an Order [Tr. 48, 49] of the United States District Court for the Southern District of California, Central Division, entered on October 5, 1950, denying appellant's petition for review of an Order [Tr. 8-11] entered by the Honorable Hugh L. Dickson, Referee in Bankruptcy, enjoining appellant from enforcing provisions of the California Sales and Use Tax Law with reference to sales of five trucks by appellee. The opinion of the District Court was filed August 7, 1950, and is reported in 92 Fed. Supp. 636.

Statement of the Case.

The presentation of the issues involved in this appeal is complicated by the fact that appellant's view of the facts established by the record differs fundamentally from the factual situation upon which the decision of the District Court was predicated. Furthermore, the Judge below rendered a lengthy written opinion covering 34 pages in 92 Fed. Supp. pages 636-672, inclusive, which is likewise predicated upon a factual situation which appellant submits is not supported by the record, and upon various erroneous conclusions regarding the nature and character of the California Sales and Use Tax Law. It is obvious, therefore, that Appellant's Opening Brief must concern itself not only with the issues related to the factual situation established by the record herein but also with the issues considered by the District Judge under his view of the facts.

To facilitate this Court's consideration of all the issues involved in this appeal, the argument herein will be presented in two parts. The first part of the argument will be predicated upon the record. The second part of the argument will be predicated upon the District Judge's view of the facts. To additionally simplify this presentation, each part of the argument will contain its own preliminary factual statement.

This Court is respectfully requested, considering counsel's burden in this matter and the end sought to be accomplished, viz., as concise and coherent a presentation as possible under the circumstances, to indulge this deviation from the form ordinarily employed by an appellant in his opening brief.

ARGUMENT.

PART I: ISSUES RAISED IN LIGHT OF THE FACTS ESTABLISHED BY THE RECORD.

A. Pertinent Facts.

Proceedings involving West Coast Cabinet Works, Inc., a corporation, were first commenced in the Bankruptcy Court on February 5, 1946, by the filing of a petition under Chapter XI of the Bankruptcy Act. Prior to that date the corporation had been engaged in the business of selling tangible personal property at retail in the State of California under a seller's permit issued by appellant pursuant to the provisions of the California Sales and Use Tax Law, California Revenue and Taxation Code, Division 2, Part 1. It is not disputed that prior to February 5, 1946 (the commencement of proceedings under Chapter XI) the corporation duly filed with appellant the returns required by the California Sales and Use Tax Law. Nor is it disputed that the tax attributable to the sales reported on said returns was duly paid to appellant as required by said law. [Tr. 86-87.]

Upon the filing of the corporation's petition under Chapter XI of the Bankruptcy Act on February 5, 1946, George T. Goggin was appointed as receiver, and on February 26, 1946, Mr. Goggin was additionally nominated to act as trustee of the corporation's estate in the event adjudication occurred. Mr. Goggin's prospective nomination as trustee was duly approved by the referee having jurisdiction. [Tr. 87.]

Upon his appointment as receiver in the Chapter XI proceedings commenced by West Coast Cabinet Works, Inc. (thereupon the debtor in those proceedings), Mr. Goggin applied for and obtained from appellant a seller's permit to engage in the business of selling tangible per-

sonal property, and it is not disputed that Mr. Goggin, as receiver, engaged in the business of selling tangible personal property at retail in the State of California from February 5, 1946, to and including March 11, 1946. Nor is it disputed that the returns and tax payments required by the California Sales and Use Tax Law for that period were duly filed and paid, respectively, by Mr. Goggin, as receiver. [Tr. 87-88.]

On March 12, 1946, West Coast Cabinet Works, Inc., was adjudicated bankrupt, and pursuant to the aforesaid nomination Mr. Goggin was duly appointed trustee in bankruptcy of said corporation's estate. Again, as was the case when Mr. Goggin was appointed receiver of this corporation under Chapter XI, he applied for and obtained from appellant a permit to engage in the business of selling tangible personal property in the State of California, and appellee stipulated in the course of the hearing before the Referee from which this appeal originates that appellee was engaged in the sale of tangible personal property at retail in the State of California during the period commencing March 12, 1946, *to and including May 1, 1946.* [Tr. 88.] It was further stipulated that not only had appellee engaged in the sale of tangible personal property at retail in this state during the period March 12, 1946, to May 1, 1946, inclusive, but also that appellee had filed with appellant the returns required by the California Sales and Use Tax Law for that period and paid the tax on the taxable sales reported thereon. [Tr. 88.]

The record further discloses [Tr. 63-66] that numerous retail sales and sales for resale were made by Mr. Goggin, first as receiver and then as trustee, during the period commencing March 12, 1946, *to and including May 14, 1946.*

On or about September 13, 1946, upon audit of the returns filed by appellee, as aforesaid, appellant duly determined in the manner provided for by the California Sales and Use Tax Law that appellee was indebted to it under said law for taxes attributable to the sale of five trucks on March 29, 1946, which had not been reported by appellee upon the returns filed by him, as aforesaid. [Tr. 6, 66, 89.] Appellee did not contest appellant's determination of additional taxes due by the filing of the petition for redetermination, as provided for by the California Sales and Use Tax Law, nor did he pay the additional tax and interest determined to be due after the additional determination became final under said law. [Tr. 89.] Upon appellee's failure to pay the additional determination and interest, after the determination became final, appellant thereupon added to the determination of additional tax due the ten per cent penalty imposed by the Sales and Use Tax Law for failure to make timely payment. [Tr. 89.]

On October 3, 1946 [Tr. 4] appellee obtained from the Referee in Bankruptcy an *ex parte* Order directed to appellant Board members requiring them to appear before the Referee and show cause why they should not be permanently enjoined and restrained from enforcing the provisions of the California Sales and Use Tax Law against appellee. The Referee directed service by mail. The petition upon which said Order to Show Cause was issued (amended by stipulation) made it clear that the enforcement sought to be enjoined thereby was collection of the tax, penalty and interest determined to be due appellant from appellee, as aforesaid, with respect to the sale of five trucks by appellee on March 29, 1946. [Tr. 5-7, 66, 89.] *Reference to the entire record herein fails to disclose that appellant took any action of any kind*

whatsoever to collect the aforesaid additional sales tax determination beyond notifying appellee that said determination had been made. Appellant did not at any time file a claim or proof of claim for the aforesaid tax liability in the Bankruptcy Court.

Pursuant to the aforesaid Order to Show Cause, hearings were had before the Honorable Hugh L. Dickson, the Referee in Bankruptcy having jurisdiction of the bankrupt estate, and on December 9, 1946, the Referee permanently enjoined appellant from attempting in any manner whatsoever to enforce against appellee or the within bankrupt estate payment of the aforesaid additional determination. Additionally enjoined was any enforcement of or attempt to enforce, against appellee or the within bankrupt estate, any of the provisions of the California Sales and Use Tax Law with reference to the aforesaid sales on March 29, 1946.

On January 7, 1947, appellant duly petitioned [Tr. 11-20] for review of the aforesaid Referee's Order, and on February 19, 1947, the Referee filed his Certificate on Review. On February 14, 1949 [Tr. 24], pursuant to a stipulation of counsel dated February 9, 1949 [Tr. 24-29], the District Judge before whom the aforesaid Petition for Review was pending ordered the Referee's Certificate amended pursuant to said stipulation.

The Court's attention is directed to the fact that the stipulation, pursuant to which the Referee's Certificate was amended, makes part of the record testimony and evidence establishing (1) appellant's administrative practice in applying the California Sales and Use Tax Law in connection with liquidating sales, and (2) that audit of appellee's activities during the period March 12, 1946, to

April 14, 1946, inclusive [see Tr. 64-66], disclosed 44 sales of tangible personal property; that 32 of such sales were retail sales, or, in other words, sales to ultimate consumers or for purposes other than resale; that 12 of such sales were sales for resale; *and that 9 of the aforesaid 44 sales of tangible personal property were sales of cabinets or cupboards which were manufactured in the course of the appellee's operation of the bankrupt's business.* [Tr. 28.]

The Court's attention is additionally directed to the First and Final Report and Account of Receiver, Petition to pay expenses of administration and Petition for discharge, filed by appellee with the Bankruptcy Court on July 17, 1946. [Tr. 52-53.] It is clear from paragraphs II and V thereof that George T. Goggin, as receiver, maintained and operated the business of the bankrupt from February 5, 1946, to March 12, 1946, and that he claimed, and was allowed, compensation therefor. The Order approving appellee's First Report and Account dated August 20, 1946 (after a hearing thereon on August 8, 1946), specifically allowed appellee the sum of $450.00, apparently as an additional fee for operating the bankrupt's business as receiver, and the further sum of $500.00 was paid to appellee *for operating the business as trustee* in addition to the trustee's fee.

After amendment of the Referee's Certificate, as set forth above, to add the matters indicated to the record herein, and after appellant's Petition for Review was heard by the Honorable Jacob Weinberger, Judge of the District Court, the Judge filed his Opinion which is reported in 92 Fed. Supp. 636. Counsel for appellee prepared proposed findings and on August 24, 1950, appellant filed its objections thereto. [Tr. 35-38.] There-

after, pursuant to a minute order (Judge Weinberger's calendar August 29, 1950) appellant prepared and filed proposed findings pursuant to the aforesaid objections. [Tr. 38-43.]

On October 2, 1950, Judge Weinberger filed his Findings and Conclusions of Law and formal Order [Tr. 43-49] denying the Board's Petition for Review.

B. The District Court's Findings Are Not Supported by the Record.

It is to be noted that Judge Weinberger in his findings specifically found that appellee conducted the business of the bankrupt and engaged in the business of selling tangible personal property at retail *only* to and including March 22, 1946 *despite* the fact that the stipulation of facts previously referred to [Tr. 88] entered into by and between counsel for the parties to this appeal, in the course of the hearing before the Referee on the Order to Show Cause involved herein, specifically establishes that during "the period from March 12, 1946, to May 1, 1946, George T. Goggin, as trustee for said bankrupt, was engaged in the sale of tangible personal property at retail in the State of California and filed with the Board sales tax returns and reported and paid sales tax on the taxable sales so reported in said returns. . . ." The foregoing finding was made by the Judge despite the fact that the record herein establishes retail sales made by appellee from March 26 to May 14, 1946, ten of which, at least, were made from the premises at which appellee was operating the bank-

rupt's business. [Tr. 53.] Reference to Board's Exhibit "A" [Tr. 64-66] discloses that appellee's last sale on May 14, 1946, was a sale of cabinets completed after March 29, 1946.

Judge Weinberger's Findings of Fact, paragraph VIII, to the effect that appellant "prior to the issuance by the Referee of the injunction herein, and at the time of the issuance of said injunction was attempting to, and unless restrained will, enforce the provisions of said law against the trustee and the bankrupt estate herein" is entirely unsupported by the record which discloses that the only action taken by appellant consisted of making the additional determination in the manner provided for by the California Sales and Use Tax Law and making a demand for the payment thereof. There is nothing in the record to intimate, even remotely, that any improper action against appellee or the within bankrupt estate was ever contemplated by appellant.

In paragraph IX of his Findings the District Judge again found as a fact, contrary to the record herein as outlined above, that appellee did not conduct any business nor engage in the business of selling tangible personal property subsequent to March 22, 1946.

It will serve no purpose to repeat here the full extent of the District Judge's deviation from the record in his Findings of Fact, inasmuch as the extent of that deviation is fully outlined in appellant's objections to appellee's proposed Findings and in the proposed Findings prepared by appellant. [Tr. 35-43.]

Briefly summarized, however, appellant submits that the record herein establishes clearly that the five trucks sold on March 29, 1946, were sold by appellee during a period in which he was operating the business of the bankrupt. It is not disputed that the five sales of trucks were liquidating sales.

C. Issues Raised in Light of the Facts Established by the Record.

1. May a Referee in Bankruptcy, *ex parte,* solely upon petition of a trustee in bankruptcy in a proceeding to which neither the State of California nor the agency here involved is a party obtain jurisdiction of the State of California and/or said agency by the issuance of an order to show cause peremptorily directing the agency to appear and show cause why it should not be enjoined from enforcing a valid state taxing statute with respect to activities of a trustee in bankruptcy during a period in which he was operating the business of a bankrupt?

2. Assuming, *arguendo,* that a bankruptcy referee has jurisdiction to issue an order to show cause as outlined in the preceding paragraph, are the gross receipts from liquidating sales made by a trustee in bankruptcy, during a period in which he is operating a bankrupt's business, includible in the measure of the tax imposed upon said trustee by the California Sales and Use Tax Law for the privilege of engaging in the business of making sales of tangible personal property at retail?

D. Specification of Errors.

1. The District Judge failed to recognize that the proceedings before the Referee amounted to a suit against the State of California without its consent.

2. The District Judge failed to give effect to the provisions of Section 960, 28 U. S. C., which provides that any officer or agent conducting any business under authority of the United States Court shall be subject to all State taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

3. Assuming the District Judge had jurisdiction to determine the tax question involved, he erroneously concluded that the gross receipts derived by a trustee in bankruptcy from liquidation sales made during a period within which the trustee was operating a bankrupt's business, and engaging in the business of making sales of tangible personal property at retail, are not includible in the measure of the tax imposed by the California Sales and Use Tax Law upon retailers for the privilege of engaging in that activity.

E. It Is Elementary That a State Cannot Be Sued Without Its Consent.

A state's immunity from suit without its consent, either directly or through one of its duly constituted agencies, is too well established to warrant discussion.

Willoughby on the Constitution of the United States, Vol. 3, 2d Ed. (1929), commencing at page 1381, and at page 1396;

49 Am. Jur., at pages 301, 304.

F. Neither the State of California Nor Its Duly Authorized Taxing Agency, the California State Board of Equalization (Appellant Herein) Was a Party to the Bankruptcy Proceeding Involving the West Coast Cabinet Works, Inc.

Bankruptcy proceedings are proceedings *in rem.*

1 Remington on Bankruptcy, 40 *et seq.*

Upon the commencement of a bankruptcy proceeding by the filing of an appropriate petition, the bankruptcy court obtains jurisdiction only of the bankrupt, the bankrupt's estate and creditors of the bankrupt.

It is apparent from the record herein that the bankruptcy referee did not attempt to obtain jurisdiction of appellant as a creditor of the bankrupt, for, obviously, the Referee's Order to Show Cause related to a tax liability attributable to the activities of appellee, the trustee in bankruptcy.

G. The Proceedings Below in Effect Amounted to a Suit Against Appellant, a Duly Constituted Agency of the State of California.

Inasmuch as appellant was not asserting a claim in the bankruptcy proceedings involving West Coast Cabinet Works and, accordingly, was not a party to that proceeding, it is apparent that for there to be a valid injunction against appellant this Court must conclude that appellee commenced some independent proceeding to which appellant was properly made a party in a court of competent jurisdiction.

We are not aware of any proceeding or any suit properly commenced by appellee against appellant in con-

formity with the provisions of the Judicial Code. For this Court to uphold the Order below, accordingly, it must necessarily conclude that appellee somehow properly commenced a suit against appellant in an authorized manner. We are unable to perceive how such a conclusion can be reached.

H. The State of California Has Specifically Denied Its Consent to Procedure by Way of Injunction, Mandamus, or Other Legal or Equitable Process to Prevent or Enjoin the Collection of Any Tax Under the California Sales and Use Tax Law.

Even if it be assumed, *arguendo,* that appellee did appropriately attempt to commence an action against appellant for an injunction, that action will nevertheless not lie since the State of California has specifically denied its consent to a suit against it to enjoin the collection of any tax liability arising under the California Sales and Use Tax Law.

California Constitution, Article XX, Section 6;

California Sales and Use Tax Law, California Revenue and Taxation Code, Div. 2, Part 1, Sec. 6931.

I. Federal District Courts Do Not Have Jurisdiction to Enjoin the Collection of State Taxes Under a Valid Taxing Statute Where an Adequate Remedy Exists Under State Law.

Apart from considerations of immunity and consent to a suit, it is to be noted that Federal District Courts are courts of limited jurisdiction having only such jurisdiction as Congress has specifically conferred upon them. It is clear from the provisions of Section 1341, 28 U. S. C., that

the power conferred upon Federal District Courts does *not* include the power to enjoin the collection of state taxes under a valid taxing statute where an adequate remedy exists under state law. It has been established in Federal District and Appellate Courts that an adequate remedy does exist under the California Sales and Use Tax Law.

Nevada-California Electric Corp. v. Corbett, 22 Fed. Supp. 951;

Corbett v. Printers & Publishers Corp., Ltd., 127 F. 2d 195.

(We note at this point that the District Judge did not agree with appellant's contention that a speedy and adequate remedy was available to appellee. However, the District Judge's conclusion was predicated upon the numerous erroneous premises discussed below in our analysis of his Opinion.)

The Court's attention is additionally directed, insofar as jurisdiction of the Federal District Court is concerned, to the fact that, if it holds Section 1341 inapplicable here, appellee did not comply with Rules 3, 4 and 8 of the Federal Rules of Civil Procedure in attempting to bring a suit for injunction against appellant.

Additionally noted should be the provisions of Sections 2281 and 2284, 28 U. S. C., which provide that even in instances where a State board such as appellant seeks to enforce an unconstitutional state statute an injunction may be issued only by a three judge court.

J. In Any Event the Taxes in Question Were Properly Imposed Upon Appellee.

This point will be discussed here on the assumption that the tax question involved is properly before this Court, and without regard to the District Judge's Opinion, which will be analyzed below.

1. Nature of the Tax.

The California sales tax is imposed upon "all retailers" at the rate of three per cent (for a time two and one-half per cent) of the gross receipts derived by them from the sale of "all tangible personal property sold at retail in this state." (California Sales and Use Tax Law, Revenue and Taxation Code, Section 6051.)

"Retailers" are defined in Section 6015 of the Sales and Use Tax Law. Prior to July 1, 1949, and during the period involved herein, the definition of "retailer" included "Every person engaged in the business of making sales at retail or in the business of making retail sales at auction of tangible personal property owned by the person or others." In 1949 (California Statutes 1949, Chapter 728 —operative July 1, 1949) the foregoing quoted language was amended to read "Every seller who makes any retail sale or sales of tangible personal property and every person engaged in the business of making retail sales at auction of tangible personal property owned by the person or others."

The term "business" is defined by the California Sales and Use Tax Law as including "any activity engaged in by any person or caused to be engaged in by him with the object of gain, benefit, or advantage, either direct or indirect."

As construed by the California Supreme Court, the term "business", as employed in the California Sales and Use Tax Law, does not necessarily involve the making of a profit, nor does it necessarily involve the operation of a business enterprise in the general sense. In *Union League Club v. Johnson*, 18 Cal. 2d 275, the California Supreme Court held that gross receipts from the operation of a dining room and bar of a non-profit corporation organized for social and political purposes were nevertheless subject to the sales tax because some gain, benefit or advantage was derived therefrom by the Club. In *Los Angeles City High School District v. State Board of Equalization*, 71 Cal. App. 2d 486, the California District Court of Appeal held that a school district was engaged in "business" within the purview of the California Sales and Use Tax Law by virtue of retail sales, averaging two or three per quarter over a period of several years, of tangible personal property no longer needed for school purposes. Obviously, a school district is not a business enterprise in the ordinary, general sense nor would the liquidation of equipment no longer needed for school purposes be generally characterized as a business enterprise in the general sense. Similarly, in *People v. County of Imperial*, 76 Cal. App. 2d 572, a county was held to be engaged in "business" within the purview of the California Sales and Use Tax Law by virtue of sales made, over a period of years, of materials and equipment originally acquired but no longer needed for use in constructing and maintaining roads and highways.

2. Appellee Was Within the Purview of the Taxing Statute.

It is clear from the foregoing provisions and cited cases that the California sales tax is imposed upon those making sales of tangible personal property at retail for gain, benefit, or advantage, either direct or indirect, and it would appear not to require further argument to support the contention that appellee, by virtue of the numerous sales made in the relatively short period commencing March 12, 1946 and ending May 14, 1946, was subject to the California sales tax.

The learned Judge below, however, predicated his opinion in part upon the premise that a trustee in bankruptcy is not a "person" within the definition of Section 6005, and, accordingly not subject to the California sales tax. The decision of this Court in *State Board of Equalization v. Boteler,* 131 F. 2d 386, is also cited. The fact that the definition of "person" as it read when it was considered by this Court in *State Board of Equalization v. Boteler, supra,* was thereafter changed to include therein "trustees" and "the United States" was recognized by the District Judge but he concluded that if the Legislature had intended to overrule this Court's views in *State Board of Equalization v. Boteler, supra,* it would have specifically said so by adding to the definition of "person" "trustee in bankruptcy" rather than merely "trustee." Ignored entirely by the District Judge is the inclusion of "the United States" in the definition of the word "person" concurrently with the inclusion of "trustees." If we understand appellee's

contentions correctly and the views of the District Judge, it was held below that trustees in bankruptcy are not included in the definition of "persons" because they are in effect officers of the United States and not to be blithely characterized as "trustees." If this contention be valid, however, it must necessarily follow from the inclusion of "the United States" in the definition of "person" that trustees in bankruptcy, as officers of the judicial arm of the United States, *are* clearly included within the definition of "person."

As additional support for the proposition that the Legislature intended the California Sales and Use Tax Law to apply to trustees in bankruptcy, this Court's attention is directed to Section 28 of the California Revenue and Taxation Code, which provides that as used in Division 2 of that Code (the California Sales and Use Tax Law being Part 1 of said Division 2) the term "person" shall include, in addition to the items of definition contained in Section 19, "trustee, trustee in bankruptcy, receiver, executor, administrator or assignee." Section 19 includes within the definition of "person" any person, firm, partnership, association, corporation, company, syndicate, estate, business, trust, or organization of any kind." Sections 19 and 28 are found in the preliminary portion of the Revenue and Taxation Code entitled "General Provisions" and Section 5 thereof specifically provides that "Unless the context otherwise requires, the general provisions hereinafter set forth govern the construction of this code."

The opinion below concludes that the definition of "person" in Sections 19 and 28 is not pertinent to a consideration of the definition of that term in the California Sales and Use Tax Law; firstly, on the ground that Section 6002 of the law specifically excludes definitions other than contained in that law, and secondly, since Section 28 was added by an enactment primarily concerned with the administration and collection of the Motor Vehicle Fuel License Tax and so entitled. It is submitted that the addition of Section 28 in 1943 and the amendment of Section 6005 in 1945 to specifically include "trustees" and "the United States" in the definition of "person" as used in the California Sales and Use Tax Law, coupled with the decision of this Court in November of 1942 (*State Board of Equalization v. Boteler, supra*), constitute a clear refutation of the contention that the California Legislature did not intend to affirm the inclusion of "trustees in bankruptcy" within the definition of those subject to the provisions of the California Sales and Use Tax Law.

We are unable to perceive a logical basis for concluding that although the California Legislature added Section 28 to clearly place trustees in bankruptcy within the scope of the Motor Vehicle Fuel License Tax Law it did not intend to make such trustees subject to the Sales and Use Tax Law, even though the broadened definition of "persons" to include trustees in bankruptcy for purposes of the Motor Vehicle Fuel License Tax Law was placed in the "General Provisions" portion of the Revenue and

Taxation Code, and despite the fact that the definition of "person" in the Sales and Use Tax Law itself was broadened to even a greater extent by the use of the words "the United States" rather than by reference to merely a specific federal officer or agent.

3. **The Gross Receipts Derived by Appellee From the Sales Involved Were Properly Included in the Measure of His Sales Tax Liability.**

The only question remaining for consideration, therefore, is whether gross receipts derived by appellee from the sale of capital assets, namely, five trucks held by him in the course of his retail sales activity, are includible in the measure of the tax imposed upon appellee as a retailer under the California Sales and Use Tax Law.

The California Supreme Court in *Bigsby v. Johnson,* 18 Cal. 2d 860, and *Northwestern Pacific Railroad Co. v. State Board of Equalization,* 21 Cal. 2d 524, has held that a retailer is required to pay sales tax measured by his receipts from the sale of equipment during his operation of a retail business enterprise, and it is submitted that those cases are decisive of the point at issue here.

Appellee should have included in the returns filed with appellant under the California Sales and Use Tax Law, for the period March 12, 1946 to May 1, 1946, the gross receipts received by him from the sale of five trucks at retail on March 29, 1946, and paid the tax attributable thereto.

PART II: ANALYSIS OF THE OPINION BELOW.

A. Preliminary Statement.

As we indicated in the preliminary paragraphs of this brief, appellant desires to present to this Court, for its consideration, all the issues considered and raised by the learned District Judge in his lengthy Opinion. The imposition of the California sales tax upon liquidation sales made by trustees in bankruptcy is a question of great importance which has occurred with vexatious frequency in most bankruptcy proceedings, and inasmuch as the District Judge recognized the importance of the problem and devoted an exceptional amount of time and energy to its consideration, it is appellant's thought that a consideration of the points discussed by the Judge in his Opinion below in the sequence employed by him would serve best to delineate the numerous facets of the problem presented.

In the following portion of this brief, accordingly, the matters discussed in the Opinion below will be discussed *seriatim,* with appropriate headings and references to the pagination of the printed report, 92 Fed. Supp. 636.

B. The Facts Upon Which the Opinion Below Was Predicated.

The learned Judge below predicated his entire Opinion upon the assumption that appellee did not operate the business of the bankrupt subsequent to March 22, 1946 (the record to the contrary, as we have attempted to point out above) and that the Court was concerned solely with liquidation sales made on March 29th by a trustee in bankruptcy who was *not* operating a business and accordingly not within the purview of Section 960, 28 U. S. C.

This assumption was made by the Judge below despite his awareness of the fact that at least ten retail sales were made by appellee prior and subsequent to March 29, 1946 and reported to appellant as taxable sales pursuant to the provisions of the California Sales and Use Tax Law.

C. Applicability of Section 960, 28 U. S. C., Formerly Section 124a of That Title.

Despite his assumption in the preliminary portion of his opinion that appellee did not operate the business of the bankrupt subsequent to March 22, 1946 and that the sale of five trucks on March 29, 1946 was part of a purely liquidating activity, the Judge below nevertheless purported to consider appellant's contention that gross receipts from the sale of capital equipment by a retailer are includible in the measure of the tax imposed upon the retailer by the California Sales and Use Tax Law. The Judge noted the decisions of the California Supreme Court in *Bigsby v. Johnson, supra* (18 Cal. 2d 860), and *Northwestern Pacific Railroad Co. v. State Board of Equalization, supra* (21 Cal. 2d 524), but instead of applying those cases to the facts established by the record, relying rather on his assumption that appellee was not conducting any business after March 22, 1946, the District Judge cites the decisions in *Boteler v. Ingels,* 308 U. S. 57, 521, 60 S. Ct. 29, 84 L. Ed. 78, 442; *Palmer v. Webster & Atlas Bank,* 312 U. S. 156, 163, 61 S. Ct. 542, 85 L. Ed. 642; *Zimmer v. New York Taxing Commission,* 2 Cir., 126 F. 2d 604 (certiorari denied 316 U. S. 701, 62 S. Ct. 1299, 86 L. Ed. 1769); *Thompson v. State of Louisiana, et al.,* 8 Cir., 98 F. 2d 108, 111 (and cases cited therein); *In re California Pea Products,* D. C., 37 Fed. Supp. 658, and *In re Davis Standard Bread Co.,* D. C., 46 Fed. Supp. 841

(affirmed 131 F. 2d 386), all to the effect that former Section 124a, 28 U. S. C. (now Section 960 of that title), does not apply to a trustee who does not conduct any business. Obviously, a trustee in bankruptcy engaged in activities not falling within the purview of Section 960, 28 U. S. C., is not subjected to all state taxes in the manner provided for by that section. (Op. 640-642.)

Also discussed by the Judge below in connection with this point (Op. 642) are the decisions in *In re Mid America Co.,* 31 Fed. Supp. 601, a decision of an Illinois district court, and *State of Missouri v. Gleick,* 8 Cir., 135 F. 2d 134, which held that liquidating trustees are conducting business within the purview of former Section 124a (now Section 960, 28 U. S. C.) and that they are, accordingly, subject to all state taxes, as would be private individuals. Although the court in the *Mid America* case specifically concluded that the phrase "conduct any business" should not receive a narrow and restricted interpretation but should be construed to include any activity or operation in connection with the handling and management of the bankrupt estate and despite the fact that Section 959, 28 U. S. C., specifically provides that a trustee appointed in any cause pending in any court of the United States (including a debtor in possession) shall manage and operate property in his possession as such trustee or manager in accordance with the requirements of valid state laws as if the owner were in possession thereof, the Judge below did not follow the *Mid America* decision. Although the United States Court of Appeals for the Eighth Circuit followed the reasoning of the United States Supreme Court in *Graves v. People of State of New York, ex rel. O'Keefe,*

306 U. S. 466, 59 S. Ct. 595, 83 L. Ed. 927, concluding that application of the therein contested state taxing statute to a trustee in bankruptcy does by "no stretch of the imagination . . . impose any burden whatsoever upon the United States or . . . limit or restrict the bankruptcy court as a department of the federal government or the trustee in bankruptcy as an agent and officer of the court, in the discharge of the duties imposed by the bankruptcy act", and although the Judge below considered this decision (Op. 642), he distinguishes the case presently pending before this Court on the ground that the *Gleick* case involved an unemployment compensation law, which was adopted at the invitation of the national government, and not, as here, a taxing statute imposed by a state for revenue purposes only. In any event, the Judge below (Op. 643) stated he was unable to agree with the decisions in the *Mid America* and *Gleick* cases, although he failed to take into account that the California Sales and Use Tax Law places less of a burden upon a trustee in bankruptcy than did the statutes involved in those cases because under the California statute the trustee is authorized to collect from his vendees the full amount of the tax payable by him under the Sales and Use Tax Law. In other words, whereas the amounts held properly payable by trustees in bankruptcy in the *Mid America* and *Gleick* cases, and by the HOLC employee in the *Graves* case, would, upon their payment, have depleted the estates of the bankrupts involved and the HOLC employee, respectively, compliance with the provisions of the California Sales and Use Tax Law by appellee, insofar as the sale of five trucks on March 29, 1946, is concerned, would not have depleted the instant estate even to the extent of one cent.

It is submitted that the reasoning of the Illinois district court in the *Mid America* case and the United States Supreme Court in the *Graves* case, as followed by the Eighth Circuit in the *Gleick* case, should be adopted by this Court not only for legal and equitable reasons but to preserve to the State of California the revenues normally accruing in connection with the sale of tangible personal property at retail in this State. It is submitted that these considerations should prevail over the sole consideration apparently moving the Judge below, namely, that the phrase "conducting any business", as used in Section 960, 28 U. S. C., should receive a narrow and restricted construction.

(The Court's attention is directed in passing to a wholly irrelevant statement in the Opinion below, at page 643, to the effect that appellee could not at any time "acting under the orders of the court . . . have acquired any personal status as a retailer by virtue of the acts performed under such orders." Inasmuch as this statement may possibly add to the confusion which has existed in connection with liquidation sales by trustees in bankruptcy, this Court is respectfully requested to note the irrelevancy of this statement in its Opinion.)

It should also be noted at this point that the court below failed entirely to consider the applicability of Section 960, 28 U. S. C., and the California Sales and Use Tax Law to liquidating sales made by a trustee who *was* conducting a business as is the case here. See Part I, *supra.*

D. Trustees in Bankruptcy Are Subject to the California Sales and Use Tax Law Even Though They Engage Solely in Liquidation Activities if They Make a Sufficient Number of Retail Sales.

Discussed as the "Second Theory" of appellant, commencing at page 643 of the reported Opinion below, is the contention that liquidating sales, if sufficient in number and scope, in and of themselves constitute the trustee making such sales a retailer within the purview of the California Sales and Use Tax Law. After a recital of various sections of the California Sales and Use Tax Law, including the 1945 amendment of Section 6005 including "trustee" and "the United States" in the definition of "person", and reference to the addition of Section 28 to the general provisions of the California Revenue and Taxation Code specifically including "trustees in bankruptcy" within the definition of "person" as used in the portion of the Revenue Code in which the California Sales and Use Tax Law is found, the District Judge concluded at the close of page 646 of the reported Opinion below, despite the most pertinent decision of the California Supreme Court in *Northwestern Pacific Railroad Co. v. State Board of Equalization,* 21 Cal. 2d 524, that liquidating trustees in bankruptcy are not "persons" within the purview of the California Sales and Use Tax Law.

The Judge below failed to reach any conclusion as to whether a trustee in bankruptcy solely making numerous liquidation sales at retail would be subject to the provisions of the California Sales and Use Tax Law if that Law clearly purported to apply to such trustees. To the

contrary, it is apparently concluded that trustees in bankruptcy are not subject to that Law regardless of the nature of their activities, and apparently even though they be clearly conducting the business of a bankrupt. This, of course, is *contra* not only to the administrative interpretation of the California Sales and Use Tax Law by the State agency charged with its enforcement, namely, the appellant, but also contrary to the interpretation of that Law acknowledged by the appellee herein who paid sales tax upon some of the sales made by him after he was appointed trustee and by the referees and judges in this jurisdiction who for many years since the adoption of the sales tax in California have approved the payment of sales taxes by trustees in bankruptcy conducting a business. It is a matter of common knowledge that all those engaged in acting as trustees in numerous estates have for many years applied for sales tax permits, filed sales tax returns, and paid the California sales tax attributable to retail sales made by them in the course of conducting a bankrupt's business.

It is submitted that the Court below failed to recognize the specific issues in question and, in the portion of its Opinion discussed to this point, to distinguish between (1) the question as to whether trustees in bankruptcy are "persons" within the meaning of the California Sales and Use Tax Law, and, accordingly, subject to the imposition of the California sales tax without regard to any possible immunity arising from their status as officers of the Bankruptcy Court, and (2) the question as to whether there is any constitutional or statutory reason why the California Sales and Use Tax Law should not apply to trustees in bankruptcy if the first question be answered in the affirmative.

As we have attempted to point out above (and in this connection see the portion of the decision in the *Northwestern Pacific Railroad Co.* case, *supra,* 21 Cal. 2d 524, relating to the number of sales sufficient in and of themselves to constitute an individual a retailer although he is not normally engaged in the business of selling tangible personal property at retail), it is appellant's position that trustees in bankruptcy are "persons" within the purview of the California Sales and Use Tax Law and that that law is applicable to them as it is to any private person or business corporation. Secondly, if this contention is correct, it is obvious, pursuant to Section 960, 28 U. S. C., that the California Sales and Use Tax Law applies to trustees in bankruptcy "conducting any business." We are not aware of any holding since the adoption of the California sales tax in 1933 to the effect that a trustee in bankruptcy operating the business of a bankrupt is not subject to the California Sales and Use Tax Law. To the contrary, we believe this Court may take judicial notice that the files of the bankruptcy courts in this state are replete with reports and orders disclosing that the district courts have unanimously agreed with appellant's view that trustees in bankruptcy are subject to the California Sales and Use Tax Law. In view of this long-continued administrative interpretation, both by the state agency charged with the law's enforcement and the Bankruptcy Court charged with the administration of bankrupt estates, that the California Sales and Use Tax Law provisions apply to trustees in bankruptcy who operate a bankrupt's business, we are unable to comprehend how it may logically be concluded that the definition of "person" in the California Sales and Use Tax Law does not also include trustees in bankruptcy who do not operate businesses of bankrupts.

It must necessarily follow, accordingly, that trustees in bankruptcy are "persons" within the purview of the California sales tax even though they make only liquidation sales.

E. Trustees in Bankruptcy Making Liquidation Sales Only Are Retailers Within the Purview of the California Sales and Use Tax Law If the Sales Are Sufficient in Scope and Number.

The next question presented is whether liquidation sales by themselves are sufficient to constitute trustees in bankruptcy "retailers" if sufficient in scope and number. As we have pointed out above (citing decisions in *Northwestern Pacific,* 21 Cal. 2d 524, the *Los Angeles City High School,* 71 Cal. App. 2d 486; *People v. County of Imperial,* 76 Cal. App. 2d 572, and *Union League Club v. Johnson,* 18 Cal. 2d 275, cases) sales sufficient in scope and number are in and of themselves sufficient to constitute a person a retailer. See, also, Section 6006.5 of the California Sales and Use Tax Law added in 1947 by Cal. Stats. 1947, page 2030.

Once we recognize that a trustee in bankruptcy is subject to the provisions of the California Sales and Use Tax Law and that even though he engages in liquidation sales only, he is nevertheless a retailer if the sales are sufficient in scope, number and character, the question in reality presented becomes apparent, namely, whether there is any federal statutory or constitutional prohibition against the application of the tax.

F. There Is No Federal Constitutional or Statutory Prohibition Against the Imposition of a Non-Discriminatory State Tax Upon Trustees in Bankruptcy.

Once the real issue involved herein is recognized, the *Mid America* case, *supra* (31 Fed. Supp. 601), the *Missouri v. Gleick* case, *supra* (135 Fed. 2d 134), and the United States Supreme Court decision in the *Graves* case, *supra* (306 U. S. 466, 59 S. Ct. 595, 83 L. Ed. 927), are brought into focus, insofar as their relevancy to the instant appeal is concerned. Additionally, the Court's attention is directed to the decision of the Court of Appeals for the Second Circuit, in *City of New York v. Jersawit,* 85 F. 2d 225, and to the decision of the Supreme Court of Utah in *Bird & Jex Co. v. Anderson Motor Co.,* 92 Utah 493, 69 P. 2d 510.

In the *Jersawit* case, the Court was concerned with the application of the New York City sales tax which is a consumer type sales tax, rather than a tax on the seller as is the case in California, although the seller is required to collect and report and pay over to the City the tax imposed upon the consumer. Obviously, collection and payment of the New York City sales tax by a trustee in bankruptcy in that jurisdiction does not deplete the bankrupt estate (as is true with respect to the California tax, inasmuch as a trustee in bankruptcy in this jurisdiction, like the New York trustee, can collect the full amount payable to the taxing authority from his vendees). As the Court pointed out in the *Jersawit* case, noting that compliance with the taxing statute would not

deplete the bankrupt estate, compliance with the taxing statute does not impose any burden on a governmental instrumentality, and is, accordingly, not objectionable as an interference with the exercise of a supreme federal function. In the *Bird & Jex Co.* case, the Utah Supreme Court followed similar reasoning, pointing out that there is no reason for immunity inasmuch as compliance with the taxing statute does not diminish the assets of the estate being liquidated.

It is apparent from a consideration of the reported Opinion below, commencing at page 650, that the District Judge concluded he could not follow the *Jersawit* and *Bird & Jex Co.* cases because the California tax is concededly what is popularly known as a "sellers" sales tax, as distinguished from a "consumer's" sales tax. Ignored by the District Judge, however, is the language in numerous United States Supreme Court cases, some of them cited in the Opinion below, to the effect that the practical operation and effect of the state taxing statute must be considered if interference with a concededly supreme federal power is alleged. As the United States Supreme Court pointed out in *Metcalf & Eddy v. Mitchell,* 269 U. S. 514, 523, 46 S. Ct. 172, 70 L. Ed. 384, in discussing state and federal immunity from taxation by each other:

> ". . . neither government may destroy the other nor curtail in any substantial manner the exercise of its powers. Hence the limitation upon the taxing power of each, so far as it affects the other, must receive a *practical construction* which permits both to function

with the minimum of interference each with the other; *and that limitation cannot be so varied or extended as seriously to impair either the taxing power of the government imposing the tax . . . or the appropriate exercise of the functions of the government affected by it.*" (Emphasis added.)

That is precisely appellant's position.

Commencing at page 651 of the reported Opinion below, the District Judge cites *Kamp v. Johnson,* 15 Cal. 2d 187, and notes that the California Supreme Court in that decision recognized the intention of the California Legislature in adopting the California sales tax to tax *every sale* of tangible personal property unless specifically exempted. (*Cf. Banken v. State Board of Equalization,* 79 Cal. App. 2d 572, 577, and *Maranville v. State Board of Equalization,* 99 A. C. A. 1013, 1015.) However, instead of concluding from this decision, together with the California decisions previously cited, that all sellers, including trustees in bankruptcy, are clearly within the purview of the Cailfornia Sales and Use Tax Law, the District Judge erroneously concludes that Section 6018 of the California Sales and Use Tax Law purports to bring *within* the scope of the California Sales and Use Tax Law not only the optometrists already held so included by the decision in *Kamp v. Johnson, supra,* but physicians and surgeons as well. In all fairness to the District Judge, we respectfully direct this Court's attention to the fact that there are unfortunately in circulation copies of the California Sales and Use Tax Law which contain an inaccurate version of the provisions of Section 6018. That section as added by California Statutes 1947, page 656, in effect September 19, 1947, in fact provides that licensed physicians and surgeons as well as optometrists,

are *consumers* and shall *not* be considered retailers for sales tax purposes with respect to ophthalmic materials used or furnished by them in the performance of their professional services in the diagnosis, treatment or correction of conditions of the human eye including the adaption of lenses or frames for the aid thereof.

In other words, the California Legislature specifically bestowed an exemption upon physicians, surgeons and optometrists who would otherwise be subject to tax pursuant to the views expressed by the California Supreme Court in *Kamp v. Johnson, supra.* The Judge below was undoubtedly misled by copies of the law which omit the word "not" and convey the impression that Section 6018 provides that licensed optometrists or physicians and surgeons *shall be* considered retailers.

Commencing with the fourth paragraph on page 651 of the reported Opinion below, the District Judge discusses the decisions rendered by the California and United States Supreme Courts in the *Richfield Oil* case, 27 Cal. 2d 150, 163 P. 2d 1, 329 U. S. 69, 67 S. Ct. 156, 91 L. Ed. 80. As the District Judge noted, the *Richfield Oil* case was concerned with the prohibition contained in the Federal Constitution against the imposition of a state tax on exports and not with the impact of the imposition of a state tax in a field in which the supreme power of Congress to regulate is well recognized, such as interstate commerce and bankruptcy. The Supreme Court itself in the *Richfield Oil* case recognized the now well established rule which governs cases involving the power of a state to impose a tax in a field where the federal power to regulate is supreme. As the United States Supreme Court noted in its decision, "accommodation has been made by *upholding* taxes designed to make interstate

commerce bear a fair share of the cost of local government from which it receives benefits . . . and by invalidating those which *discriminate against* interstate commerce, which *impose a levy for the privilege of doing it,* which *place an undue burden* on it. . . ." (Emphasis added.)

That is precisely appellant's position.

To our knowledge, there is no absolute prohibition, such as is contained in the import-export clause of the Federal Constitution, nor any other prohibition against the imposition of a non-discriminatory tax upon trustees in bankruptcy if the taxing statute realistically imposes no levy upon the trustee for the privilege of performing his duties (a bankrupt estate would not be depleted even one cent's worth if the trustee complied with the California Sales and Use Tax Law, as we have pointed out above), and places no undue burden on the trustee in bankruptcy (as the United States Supreme Court well recognized in *Graves v. People of the State of New York, supra,* 306 U. S. 466, 59 S. Ct. 593, 83 L. Ed. 927, when it upheld a state's right to tax the salary of a federal employee).

The Court's attention is additionally directed to the fact that the burden imposed on a trustee in bankruptcy by the California Sales and Use Tax Law is certainly less than the burden imposed on the HOLC employee in the *Graves* case, *supra,* inasmuch as the HOLC employee was required to pay the state tax from his own funds in addition to filing a state tax return, whereas trustees in bankruptcy would pay nothing from the bankrupt estate but merely, in effect, collect the amount of tax and report and pay it to the State of California.

G. Although It Is Not Disputed That the California Sales Tax Is a Tax Imposed on the Seller, the Practical Operation of the State Taxing Statute Must Be Considered.

The Judge below felt it necessary to cite numerous cases, *People v. Herbert's of Los Angeles,* 3 Cal. App. 2d 482; *Roth Drug, Inc., v. Johnson,* 13 Cal. App. 2d 720; *Western Lithograph Co. v. State Board of Equalization,* 11 Cal. 2d 156; *National Ice & Cold Storage Co. of California v. Pacific Fruit Express Co.,* 11 Cal. 2d 283; *People v. Monterey County Ice, etc.,* 29 Cal. App. 2d 421, and *Ainsworth v. Bryant,* 34 Cal. 2d 465, to support his conclusion that the California sales tax is a tax legalistically imposed on the seller and not the consumer, even though this point has at all times been conceded by appellant. Similarly, the Judge below felt it necessary to cite the *Aero Mayflower Transit Co.* case, 332 U. S. 495, 68 S. Ct. 167, 92 L. Ed. 99, and cases cited therein, to support the proposition (again at all times conceded by appellant) that federal courts are bound by the construction placed upon a state statute by the highest court of the state.

We are unable to comprehend, however, how the technical, legalistic character of the California sales tax, as a tax upon the seller, can be determinative of the conclusion to be reached as to whether the imposition of the California sales tax upon trustees in bankruptcy amounts to an unconstitutional interference with the exercise by Congress of its recognized supreme power in the field of bankruptcy. The very cases cited by the Judge below on this point, namely, *Martin Ship Service Co. v. City of Los Angeles,* 34 Cal. 2d 793, quoting from the de-

cision of the United States Supreme Court in *Interstate Oil Pipe Line Co. v. Stone,* 337 U. S. 662, 69 S. Ct. 1264, 93 L. Ed. 1613; *State of Wisconsin v. J. C. Penney Co.,* 311 U. S. 435, 61 S. Ct. 246, 85 L. Ed. 267; *International Harvester Co. v. Wisconsin Department of Taxation,* 322 U. S. 435, 64 S. Ct. 1060, 88 L. Ed. 1373, and *Richfield Oil Co. v. State Board of Equalization, supra* (329 U. S. 69, 67 S. Ct. 156, 91 L. Ed. 80), all stand for the proposition that the practical operation of challenged state statutes must be looked to and not their descriptive labels. As the Judge below recognized (Op. 653), the United States Supreme Court has stated again and again, in considering the question here involved, that it will look to the actual incidence of the tax and its practical operation in determining whether the taxpayer is deprived of a federal right or whether the state is within its constitutional power, not to the characterization of the state taxing statutes by state courts.

It necessarily follows, accordingly, that there is no constitutional objection to the imposition of the California sales tax upon trustees in bankruptcy inasmuch as in the practical operation of that taxing statute no burden is placed upon the trustees in bankruptcy, as we have pointed out above, by virtue of the provision in the California Sales and Use Tax Law authorizing sellers to collect the full amount of tax payable by them from their vendees. We, accordingly, see no reason why this Court cannot express itself regarding the constitutionality of the California Sales and Use Tax Law, as applied to appellee herein, even in the light of the decision of the United States Supreme Court in the *Spector Motor Service* case cited by the Judge below. (323 U. S. 101, 65 S. Ct. 152, 89 L. Ed. 101.)

H. Principles of Statutory Construction Should Not Be Loosely Applied to Support a Predetermined Conclusion.

Commencing at page 654 of the reported Opinion below, the learned District Judge cited various cases bearing upon the application of well recognized principles of statutory construction to support his conclusion, which was quite apparent at this point in his Opinion, that the California sales tax cannot constitutionally be imposed upon trustees in bankruptcy in connection with liquidation sales made by them. It is submitted, however, that the Judge below applied these principles of statutory construction with a complete disregard for the practical operation of the California Sales and Use Tax Law insofar as trustees in bankruptcy are concerned.

For example, at page 655 of the reported Opinion, the District Judge quotes from the decision of the United States Supreme Court in *Davies Warehouse Co. v. Bowles,* 321 U. S. 144, 64 S. Ct. 474, 88 L. Ed. 635, wherein that Court considered a contention that an exemption provision in a federal statute must receive an interpretation "as a matter of principle which will give the exemption a general and uniform operation in all states irrespective of local law." Despite the fact that appellant here is seeking a decision in conformity, from the practical point of view, with the decisions rendered in the *Mid America* case, *supra* (31 Fed. Supp. 601), the *Jersawit* case, *supra* (85 F. 2d 25), and with the numerous other cases cited in the reported Opinion below with reference to the impact of a state taxing statute in a field where the fed-

eral power to regulate is concededly supreme, the reported Opinion quotes from the *Davies* case the portion of that case with which we are entirely in agreement:

> ". . . It is, of course, true that uniform operation of a federal law is a desirable end, and other things being equal we often have interpreted statutes to achieve it. But in no case relied upon did we achieve uniformity at the cost of establishing overlapping authority over the same subject matter in the state and in the Federal Government. When we do at times adopt for application of federal laws within a state a rule different from that used by a state in administering its laws, the two rules may subsist without conflict, each reigning in its own realm. It is a much more serious thing to adopt a rule of construction, which we are asked to do here, *which precludes the execution of state laws by state authority in a matter normally within state power.* . . ." (Emphasis added.)

It is emphasized at this point that the conclusion reached by the Judge below *does* preclude the execution of a valid state law by the duly constituted state agency charged with the enforcement thereof in a matter normally within the state power. Furthermore, it should be obvious at this point that appellant is not in any respect seeking to establish "overlapping authority" over the bankruptcy field where the federal power is supreme, but striving for the very uniformity favored by the United States Supreme Court.

The learned Judge below, in considering the California sales tax statute "as a whole," fails entirely to distinguish between the sections imposing the tax and the means provided for collecting it. The District Judge overlooks entirely that appellant is not seeking (nor has it, at any

time since the adoption of the California sales tax in this state) to enforce collection in a manner not entirely in accord with well established principles, including those regarding assets *in custodia legis.*

We are also unaware of any authority for the proposition that the imposition sections of a taxing statute must fall merely because some of the collection procedures set up by the taxing statute cannot be applied in all cases.

Furthermore, the Opinion below disregards one of the means of collection provided for by the California Sales and Use Tax Law in Section 6711 thereof, and the provision of Section 959a, 28 U. S. C., and cases relating thereto. Section 6711 authorizes appellant to bring a court action for the collection of amounts due under the California Sales and Use Tax Law, and Section 959a provides that trustees may be sued without leave of the Court regarding any of their acts or transactions in carrying on business connected with property of the bankrupt estate. It is also too well established to warrant citation that in cases where a trustee in bankruptcy cannot be sued pursuant to Section 959a without consent of the bankruptcy court application may be made to the bankruptcy court for leave to maintain the suit.

Considering the foregoing, accordingly, it is clear that the application here of the principle that a statute must not be so construed in its entirety as to render it ineffective or inefficient is entirely without foundation.

Without a detailed analysis of the California sales tax statute, it is nevertheless clear that in its practical operation it calls for the imposition of the tax technically upon the seller, who may reimburse himself in full by collecting the amount of tax imposed upon him from his vendee, and for the collection of that amount from him by way of

suit with or without the bankruptcy court's permission as the case may be, if the trustee is not generally subject to all state taxing statutes by virtue of Section 960, 28 U. S. C.

In passing, we note at this point that the learned Judge below also misconstrued appellant's position regarding the $1.00 permit fee requirement of the California Sales and Use Tax Law. Appellant does not contend that a trustee in bankruptcy who does not conduct a business within the purview of Section 960, 28 U. S. C., may be enjoined from, or prosecuted for, carrying out his liquidation duties if he does not obtain a California seller's permit. It is clear from a reading of Section 6066 of the California Sales and Use Tax Law that the permit requirement is a registration requirement, as was true in *O'Neil v. United Producers & Consumers Co-op.*, 57 Ariz. 295, 113 P. 2d 645, involving the Arizona Occupation Tax. It is obvious again that the registration character of the permit is not altered by the fact that various enforcement provisions (some of which may perhaps not be applicable to a trustee in bankruptcy engaged solely in a liquidation activity) are found in related sections of the California Sales and Use Tax Law.

We must emphasize again, inasmuch as it appears that a contrary impression was received by the Judge below, that appellant is not and has not at any time sought to interfere and/or restrict and/or hamper and/or inhibit in any manner whatsoever the performance of the duties imposed upon trustees in bankruptcy.

The conclusion reached by the Judge below at page 658 of the reported Opinion "that nearly every section of the sales tax provisions of said Law poses problems which not even the most practical approach could solve"

in light of the Bankruptcy Act, is predicated entirely upon the assumption that a taxing statute must fall if any of the enforcement provisions therein cannot be applied to every taxpayer thereunder. It is submitted that not a single authority can be found to support this conclusion.

I. Compliance With the California Sales Tax Statute by Trustees in Bankruptcy Would Not Give Appellant a Priority Over Other Administrative Expenses.

Commencing at the end of page 658 of his reported Opinion, the District Judge concluded that compliance by a trustee in bankruptcy with the provisions of the California Sales and Use Tax Law "would involve a priority for the State over other administrative expenses, such as compensation of counsel, etc.; . . ." The Learned Judge below was also fearful that such a priority would expose trustees in bankruptcy to the possibility of surcharge.

The fallaciousness of this reasoning is again demonstrated by reference to Section 6052 of the California Sales and Use Tax Law which authorizes the seller to collect the amount of tax, as we have pointed out above, from his vendees. Accordingly, as we attempted to impress upon the Court below, a trustee making liquidating sales in bankruptcy can inform his prospective vendees that they will be required to reimburse him for the California sales tax attributable to sales made to them and thereupon collect the amount of tax from each vendee when a sale is made. The tax reimbursement so collected, which does not constitute a portion of the bankrupt estate, can very simply be set aside in a separate fund and transmitted to appellant, together with the returns required by

the California Sales and Use Tax Law. No portion of the estate otherwise available for administrative expenses would be paid to appellant. And in cases where a trustee makes only one sale, but is not certain at that time whether he will make sales sufficient in scope and number to constitute him a retailer under the California Sales and Use Tax Law, it would be a simple matter to collect the reimbursement from the vendee pending its return to him if the amount collected were not thereafter payable under the taxing statute. It is submitted that the difficulties envisioned by the Judge below are truly ephemeral rather than real.

J. Although the Term "Trustees" Rather Than "Trustees in Bankruptcy" Is Used in Section 959, 28 U. S. C., It Is Well Established That That Term Includes Trustees in Bankruptcy.

Commencing at page 660, the reported Opinion again affirms that compliance with the applicable provisions of the California Sales and Use Tax Law by a trustee in bankruptcy will result in an interference by the state with the jurisdictional and administrative provisions of the Bankruptcy Act. We have attempted above to demonstrate that such interference would not exist.

The Court's attention is, however, directed to the paragraph which follows this additional reference to "interference" wherein the Judge below concluded that the addition of the word "trustee" to the definition of "person" in the California Sales and Use Tax Law was not motivated by the California Legislature's view that the levy of the California sales tax upon a trustee in bankruptcy for the privilege of performing mandatory functions had received implied sanction in language found in opinions

of the California and United States Supreme Courts. We are not able to so blithely conclude, especially in light of the numerous decisions cited in the Opinion below, and referred to herein above, regarding the impact of state taxing statutes in fields where the federal regulatory power is concededly supreme. We note further that Congress itself, in drafting legislation affecting trustees in bankruptcy, did not specifically refer to them as such, but, like the California Legislature, felt content to use merely the term "trustees." We will not burden this Court with a lengthy recital of all the cases holding that Sections 959 and 960, 28 U. S. C., and their predecessor sections apply to trustees in bankruptcy despite the fact that only the term "trustee" is employed in Section 959, and only the words "officers and agents" in Section 960.

K. Miscellaneous Points in Sequence.

Commencing at page 661 of the reported Opinion below, various erroneous premises and conclusions discussed above are again reiterated.

The partial quotation from the decision in *McGoldrick v. Berwind-White Coal Mining Co.,* 309 U. S. 33, 48, 60 S. Ct. 388, 393, 84 L. Ed. 565, may possibly be misleading inasmuch as the case supports appellant's position rather than appellee's. In considering the application of the New York City sales tax, which, as we have pointed out above, is a consumer's sales tax as contrasted with the California tax, the application of the New York City sales tax to trustees in bankruptcy was upheld despite its impact on interstate commerce. The paragraph following

the portion quoted in the Opinion below contains reasoning which is equally applicable to the California sales tax, and reads as follows:

> "The present tax as applied to respondent is without the possibility of such consequences [the dire consequences envisioned by the Judge below] Equality is its theme, . . . [citation]. It does not aim at or discriminate against interstate commerce. It is laid upon every purchaser, within the state, of goods for consumption, regardless of whether they have been transported in interstate commerce. Its only relation to the commerce arises from the fact that immediately preceding transfer of possession to the purchaser within the state, which is the taxable event regardless of the time and place of passing title, the merchandise has been transported in interstate commerce and brought to its journey's end. Such a tax has no different effect upon interstate commerce than a tax on the 'use' of property which has just been moved in interstate commerce sustained in Monamotor Oil Co. v. Johnson, 292 U. S. 86, 54 S. Ct. 575, 78 L. Ed. 1141; [citations] . . ."

It is submitted that the foregoing reasoning is applicable here with respect to bankruptcy.

The decision cited at page 662 of the reported Opinion below, *United States v. Pyne,* 313 U. S. 127, 61 S. Ct. 893, 85 L. Ed. 1231, is not pertinent to any issue involved in this appeal inasmuch as that decision was concerned solely with a deduction provision in a Federal Revenue Act relating to the computation of taxable net income for federal income tax purposes. It will serve no purpose for counsel to strike off at a tangent at this point to discuss at length the development for federal

income tax purposes of the deduction for expenses incurred in connection with the carrying on of business.

The repeated reference to the decision of this Court in *State Board of Equalization v. Boteler, supra* (131 F. 2d 386), and to the decisions of the District Court in this jurisdiction in *In re California Pea Products, supra* (37 Fed. Supp. 658), and *In re Davis' Standard Bread Co., supra* (46 Fed. Supp. 841), calls for a reiteration of the fact that trustees in bankruptcy engaged in activities falling within the scope of Section 960, 28 U. S. C., have always been considered subject to the California Sales and Use Tax Law since its inception. Counsel for appellant can only state in all frankness that they are unable to comprehend how this long-continued construction was not taken into account by the Court in each of the foregoing decisions. If the Court's attention was directed to that long-continued and accepted construction, we are unable to explain how in the foregoing decisions, it could have been concluded that the trustee in bankruptcy was not within the purview of the California Sales and Use Tax Law and subject to tax thereunder.

L. With Particular Reference to Administrative Construction.

Commencing at page 664 of the reported Opinion, the learned Judge concludes that although it was appellant's administrative practice to treat persons making "two or more sales . . . in any taxable period" as retailers within the purview of the California Sales and Use Tax Law, if the sales are sales at retail, this administrative construction is worthless inasmuch as it was not incorporated into a formal printed ruling of the Board.

We are unaware of any authority supporting the proposition that the long-continued administrative practice of an agency charged with the enforcement of a particular statute is to be accorded no weight whatsoever in construing that statute, if the application of well established principles of construction are called for, merely because the practice is not evidenced by a formal, printed ruling. To the contrary, it appears that the California Supreme Court has taken a view opposed to the views of the District Judge in *Coca-Cola v. State Board of Equalization,* 25 Cal. 2d 918, 921, 156 P. 2d 1, 2, wherein the California Court states:

> "Although not necessarily controlling, as where made without the authority of or repugnant to the provisions of a statute, the contemporaneous administrative construction of the enactment by those charged with its enforcement and interpretation is entitled to great weight, and courts generally will not depart from such construction unless it is clearly erroneous or unauthorized. (Shealor v. City of Lodi, 23 Cal. 2d 647 [145 P. 2d 574]; People v. Southern Pacific Co., 209 Cal. 578 [290 P. 25]; Riley v. Thompson, 193 Cal. 773 [227 P. 772]; Riley v. Forbes, 193 Cal. 740 [227 P. 768].) . . ."

Proceeding from the assumption that appellant's long-continued administrative construction is of no value, as outlined in the preceding paragraph, the Judge below then concludes that the California Legislature did not intend to include trustees in bankruptcy within the definition of "person" by the addition of the word "trustee" to the definition of "person" in Section 6005 of the California Sales and Use Tax Law. Overlooked entirely is the fact that the term "trustee" and "officers and agents" are used

in Sections 959 and 960 of 28 U. S. C., and were so used in the predecessor sections thereof. Overlooked is the fact that Section 6005 does not specifically refer to receivers in bankruptcy but only to "receivers", although it has never been denied (but to the contrary always accepted) that that the term "receiver" includes a receiver appointed by a bankruptcy court. Additionally overlooked is the fact that the Federal bankruptcy courts in this State, since the inception of the sales tax in 1933, have always considered trustees in bankruptcy and receivers in bankruptcy who operate a debtor's or bankrupt's business to be subject to the provisions of the California sales tax statute, and, accordingly, "persons" within the purview of those statutes.

M. With Further Reference to the Referee's Jurisdiction.

Commencing at page 665, the Opinion below purports to consider the jurisdiction of a referee in bankruptcy to enjoin the collection of a valid state tax by the state agency duly charged with its collection. Overlooked entirely, as we have attempted to point out above, is the fact that appellant was not a party to the bankruptcy proceedings involving West Coast Cabinet Works, Inc., at the time the referee issued his Order, *ex parte,* peremptorily requiring appellant Board members to appear before him and show cause why they should not be enjoined from enforcing the California Sales and Use Tax Law against the trustee in bankruptcy herein (appellee), in connection with his activities. Erroneously assumed, again, is the proposition that compliance with the California Sales and Use Tax Law by appellee would have resulted in interference with the bankruptcy court's control over appellee's activi-

ties and the property in its custody. Overlooked, again, is the fact that compliance with the California Sales and Use Tax Law by a trustee in bankruptcy would not impair the priority of payment of administrative expenses provided for by the Bankruptcy Act. And all these matters are overlooked despite the fact that the Judge below recognized (reported Op. 666) that "the Board had filed no petition for the allowance of the tax as an administrative expense by the bankruptcy court . . ."; and, strangely, this recognition is coupled with the erroneous statement that appellant had "threatened to enforce the provisions of the Law against the trustee and the estate of the bankrupt."

Conclusion.

We have attempted in Part II of the foregoing Argument to direct this Court's attention to most of the erroneous premises and conclusions upon which the Order below was predicated, and rather than again enumerate the matters discussed above, as well as in the remaining portion of the District Judge's Opinion (where, for example, the District Judge overlooks the 1947 amendment to the California Code of Civil Procedure, Section 401, which permits suits for refund of taxes paid under the California Sales and Use Tax Law to be brought in Los Angeles or San Francisco as well as in Sacramento), we respectfully request this Court to consider the errors discussed as additional specifications of error even though not specifically designated as such.

It is respectfully submitted that the Order below is erroneous in light of the facts established by the record herein and, additionally, that the Order below is errone-

ous even if it were properly predicated upon the factual situation set forth in the findings below.

In any event, the application of the California Sales and Use Tax Law to trustees in bankruptcy is a matter of great importance both in the administration of bankruptcy estates and the administration of the State taxing statute, and it is respectfully requested that this Court in its Opinion, regardless of whether it agrees with appellant's contention or not, fully dispose of all the doubts which have been created by the many misleading premises and conclusion in the Opinion below.

Respectfully submitted,

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No. 12727.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CALIFORNIA STATE BOARD OF EQUALIZATION,

Appellant,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of West Coast Cabinet Works, Inc.,

Appellee.

APPELLEE'S BRIEF.

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Appellee.

APPELLEE'S BRIEF.

Preliminary Statement.

Appellant has quoted a stipulation entered into before the Referee to the effect that Appellee "was engaged in the sale of tangible personal property at retail" in this State during the period March 12, 1946, to May 1, 1946, inclusive. Counsel seek to make much of this stipulation, when in truth and in fact it established nothing more than that the trustee, during such period, did make some retail sales. The court will note that the stipulation does not include the words "while conducting the business," and it was never so intended. The interpretation placed upon this stipulation by counsel for the Appellant is to the effect that such words were included, and consequently creates a furore with which counsel for Appellant so viciously attack the opinion of the District Court. We venture to state that without this false premise laid down by Appellant's counsel, much material would have to be eliminated from their opening brief.

ARGUMENT.

At the outset it should be noted that the court found from the evidence that Appellee as trustee conducted the business of the bankrupt from March 12, 1946, to March 22, 1946. On March 29, 1946, the trustee sold at public auction in open court, and subject to confirmation of court, five trucks which had been used by the bankrupt for deliveries in the conduct of its business. After adjudication an order was made to sell in liquidation. The making of said order marked the termination of Appellee's authority to conduct the business as well as the termination of the business. This is the line of cleavage between conducting the business and liquidating it. A trustee cannot then be considered as "conducting the business of the bankrupt" within the meaning of Section 2(5) of the Bankruptcy Act, 11 U. S. C. A., Section 11(5), nor as "conducting any business" within the meaning of Section 124a of Title 28, U. S. C. A., and any status such trustee may have been given by virtue of Section 124a as an "individual" or "corporation" conducting any business, is no longer to be attributed to him.

While the pertinent facts as stated in Appellant's opening brief are in the main correct, most of such facts having been stipulated to at the hearing before the Referee, we believe that a separation of the sales into the categories given to them by the District Judge is of prime importance to a clear view of the issues involved in this appeal. They are:

The Corporation.

It engaged in the business of making retail sales until the receiver was appointed.

The Receiver.

George Goggin, as receiver, also engaged in the business of making retail sales between February 5, to March 11, 1946, when the corporation was adjudicated a bankrupt. During this time the receiver conducted the business of the bankrupt, in that he renegotiated some contracts which the bankrupt already had on hand, and proceeded to complete the manufacture of articles already contracted for by the bankrupt, these articles being manufactured from materials on hand. [Tr. 91.]

The Trustee in Bankruptcy, After Adjudication.

Under an order of the Bankrupty Court permitting him to conduct the business for a limited time, conducted the business of the bankrupt and was engaged in the business of making retail sales to the extent of completing the building of two or three kitchen cabinets already contratced for from materials on hand, during the period of March 12, to March 22, 1946. [Tr. 95, 96.]

The Trustee in Bankruptcy Under an Order of Court to Liquidate.

He did not conduct the business of the bankrupt, did not conduct any business, and did not engage in the business of making retail sales, after March 22, 1946, when he received the order to sell in liquidation subject to the confirmation of the court which terminated his authority to operate the business. Exhibit A [Tr. 64, 65, 66], the record of his receipts after

March 12, 1946, until the date of May 14, 1946, show that he delivered and received payment for kitchen cabinets contracted for and completed prior to the order to sell in liquidation.

It may be mentioned here that of all of the sales made during the period after the order to sell in liquidation, Appellant complains only that the sales tax was not paid for the privilege of selling the five trucks.

Though Appellant has made the statement at page 2 of its opening brief that the District Judge's decision was predicated upon factual situation not supported by the record, actually, counsel have pointed to no distortion of the facts; Appellant's quarrel is, rather, with the conclusions of law which the lower court has drawn from those facts.

We submit that Appellant has failed to present to this Court the purport of such decision. We respectfully urge that Appellant's opening brief is predicated upon a view of the decision which finds no support therein, and we feel that a correct summary of the points covered in the opinion should be given here.

The District Judge Held:

1. The trustee herein was not subject to the Sales Tax provisions of the California Sales and Use Tax Law, in making the sales of the five trucks involved in the review of the Referee's order.

a. After March 22, 1946, on which date the trustee was ordered to sell the assets of the bankrupt estate either at public auction or private sale, he did not conduct the business of the

bankrupt within the meaning of Section 2(5) of the Bankruptcy Act, 11 U. S. C. A. 11(5); nor did he conduct any business within the meaning of Section 124a of Title 28, U. S. C. A. After March 22, 1946, he was a trustee in bankruptcy, selling the assets of a bankrupt estate, after adjudication, under order of court, in liquidation, and the fact that he had previously conducted the business of the bankrupt had no materiality.

b. The trustee herein was not included in the definition of persons subject to the California Sales and Use Tax Law, Section 6005, Revenue and Taxation Code.

(1) The California Legislature in enacting the Law used no words which expressly included a trustee such as involved herein.

(2) The California Legislature did not intend to include a trustee such as involved herein.

c. A trustee in bankruptcy making sales (at retail) of the assets of a bankrupt estate, after adjudication, under order of court, in liquidation, subject to confirmation of the court, is not "engaged in the business of making retail sales" within the meaning of the Sales Tax provisions of the California Sales and Use Tax Law, Sections 6013 (defining business), 6014 (defining seller), 6015 (defining retailer), as said sections read in 1946.

2. The Referee had jurisdiction to issue the injunction notwithstanding the provisions of Section 41(1) of Title 28, U. S. C. A., now Section 1341 of Title 28 as revised in 1948.

a. The tax, if applicable to the trustee, was an administrative expense to be examined, etc. by the Referee under Section 62a of the Bankruptcy Act, 11 U. S. C. A. 102a.

b. The Referee examined the administrative expense and found it not an administrative expense but an invalid application of the tax.

c. The enforcement of the provisions of the Law would result in an interference with the control of the Bankruptcy Court over property in its custody, and an interference with its jurisdiction in the administration of the bankrupt estate.

d. Payment of the tax under protest and suit for a refund in the State court did not provide a plain, speedy and efficient remedy for the trustee herein.

Before we point out some of the statements in Appellant's opening brief which show a misconception of the conclusions of the District Judge and of the opinion rendered by him, we wish to emphasize what counsel for Appellant seem to have overlooked; the decision was limited in its consideration to *a trustee in bankruptcy who*

made retail sales of the assets of the bankrupt estate, after adjudication, pursuant to the order of the Bankruptcy Court to sell such assets in liquidation subject to the confirmation of the Court, also, the decision of the District Court was based upon the law as it read in 1946 when the liability was alleged to have accrued.

Appellant's Counsel Have Erroneously Set Forth the Purport and Effect of the District Court's Decision.

At page 117 of the Transcript of the Record, in the "Statement of Points Upon Which Appellant Intends to Rely" at Paragraph 7, counsel state:

> "The District Judge erroneously concluded and held that, even if the California Sales and Use Tax Law does purport to apply to a trustee in bankruptcy making sales of tangible personal property in liquidation of a bankrupt estate, the trustee is nevertheless not subject to the California Sales and Use Tax Law by virtue of his status as an officer of the Bankruptcy Court."

Having stated that the District Judge *did* decide that such a trustee would not be liable for the tax, even though the California statute did purport to apply to him, counsel then proceeded, at page 26 of their opening brief, to make another and different interpretation of the decision:

> "The Judge below failed to reach any conclusion as to whether a trustee in bankrupcty solely making numerous liquidation sales at retail would be subject to the provisions of the California Sales and Use Tax Law if that Law clearly purported to apply to such trustee."

We take issue first with the statement last quoted. The District Judge, at page 663 of the opinion, mentioned that the trustee herein, when discharging his statutory duties was not "engaging in business" and was not "conducting any business." It thus follows that even if the definition of "person" in the California statute included the words "trustee in bankruptcy" and the words "making numerous liquidation sales at retail," the trustee herein would still not be liable for the tax unless his acts brought him within the classification of those "persons" who must pay for the privilege of selling at retail, *i.e.,* retailers, *i.e.,* "persons" *engaged in the business* of selling at retail.

Referring to the statement first quoted, that found in the Transcript of Record, we must contradict the assertion that the opinion held the "trustee is nevertheless not subject to the . . . Law by virtue of his status as an officer of the Bankruptcy Court."

Also, we cite as a misconstruction of the opinion, the statement found at page 18 of the Appellant's opening brief:

> "it was held below that trustees in bankruptcy are not included in the definition of persons because they are in effect officers of the United States, and are not to be blithely characterized as 'trustees.'"

We refer to the District Judge's opinion, note 13, page 649, where he found it unnecessary and unimportant to decide whether the trustee here involved should be classed as an instrumentality of the United States. The Court did not indicate at any point, that an "officer of the United States" could not be, "blithely" or otherwise, characterized as one liable for the California sales tax.

In fact, the Court below expressly recognized that Congress had provided, by Section 124a of Title 28, U. S. C. A., that a trustee in bankruptcy who conducted the business should be regarded as of such a nature as to come within the range of the state tax laws as an individual or a corporation. (Opinion p. 662.) He also recognized Congress had not seen fit to say that a trustee such as the one involved herein should be so regarded.

Indeed, no *sanctity* was attributed to the trustee herein because of his status as an officer of the Bankruptcy Court. In fact it was indicated in the opinion, at page 665, that the California Legislature should be able, if it wished to take the trouble, to include within its taxing statute a trustee in bankruptcy such as the Appellee. The lower court hinted, however, that the Legislature might have deemed the problem of avoiding conflict with the Bankruptcy Law too difficult compared to the amount of revenue it would obtain from such a trustee.

The following quotation from page 27 of Appellant's opening brief shows a glaring departure from the conclusions expressed by the lower court:

> "To the contrary, it is apparently concluded that trustees in bankruptcy are not subject to the Law regardless of the nature of their activities and apparently even though they be clearly conducting the business of a bankrupt."

We are astonished that the attorneys who signed the brief could make such a statement. Counsel know that since the beginning of these proceedings the liability of a trustee conducting the business of the bankrupt has been conceded by everyone. Further, the opinion, at page

640, discusses and quotes from cases construing Section 124a of Title 28, U. S. C. A. At page 662 it is noted that Congress could and did, by such section, fix upon a trustee in bankruptcy conducting the business of the bankrupt the "nature" of a private person or corporation for the purpose of such tax liability.

The Findings Are Supported by the Record.

Appellant argues that the District Court should have interpreted the stipulation heretofore referred to in the same light attempted by Appellant and that in effect the judge should have been bound by same. We respectfully contend that even though the stipulation had included the words "while conducting the business" (which it did not), the evidence proved directly to the contrary, and the Court would not have been bound by such stipulation.

> *Farmers and Merchants Bank of Los Angeles v. Board of Equalization of Los Angeles,* 97 Cal. 318.

It is argued by Appellant that Paragraph VIII of the findings of fact is entirely unsupported by the record because the record discloses that the only action taken by Appellant consisted of making additional determination and demand for the payment thereof. Appellant further argues there is nothing in the record to indicate that any "improper" action against Appellee was ever contemplated. The record fails to disclose that any allegation was made by Appellee that Appellant was threatening or engaging in any "improper actions." We respectfully submit it must be presumed as a matter of law that Appellant after

making demand, and payment not being made, would enforce the provisions of the Law for the payment thereof, but according to Appellant's argument, this Court would have to presume that after demand and non-payment, Appellant would take no further action for collection of said tax. Such failure to enforce the provisions of the statute would be in excess of the power of the Board, which has no authority to make exceptions where the same are not made by statute.

American Distilling Co. v. State Board of Equalization (1942), 55 Cal. App. 2d 799, 131 P. 2d 609;

People v. Universal Film Exchanges, 34 Cal. 2d 646, 213 P. 2d 697;

Crane Co. v. Arizona State Tax Commission (1945), 63 Ariz. 426, 163 P. 2d 656, 662, 163 A. L. R. 261.

We submit that there is sufficient evidence in the record to support the District Judge's finding VIII; further, that if, in the opinion of counsel for the Board there had not been sufficient evidence to support the Referee's finding which was incorporated in the said finding VIII of the District Judge, the Appellant should have made mention of the Referee's error in its Petition for Review. He should not be heard to urge on appeal a matter to which attention was not called prior to the rendition by the District Judge of his opinion herein.

We must call to this Court's attention that it does not appear anywhere in the record herein that prior to the decision of the lower court any indication whatever was made that the Board would not seek, through the en-

forcement provisions of the statute, to compel payment of the tax by the trustee or out of the bankrupt estate. It does not appear prior to such decision, that counsel questioned whether the Bankruptcy Court had obtained jurisdiction over the officers of the State Board of Equalization. It does not appear prior to such decision, that the power of the Referee or the District Judge to issue the injunction was challenged.

Appellant should not be heard to raise these questions for the first time upon appeal, especially in view of the fact that it was indicated that counsel for the Board were seeking to make a "model" case for presentation to a higher court. [Tr. 50, 70.]

The Proceedings Before the Referee Did Not Amount to a Suit Against the State of California Without Its Consent.

It is undisputed that the Appellee applied to Appellant for and obtained a license under the provisions of the California Sales and Use Tax Law, and paid to Appellant certain taxes accruing while conducting the business of the bankrupt, and that Appellant made demand upon the Appellee for further taxes.

The Appellant came into the Bankruptcy Court to license the Trustee and receive funds from the bankrupt estate. How, then, can Appellant contend that the court had no jurisdiction? If this be true, no person dealing with a receiver or trustee in bankruptcy would be subject to the jurisdiction of the Bankruptcy Court, and therefore, could treat the officers of the court in any manner they chose.

All persons dealing with officers of the court in bankruptcy proceedings during the administration of the estates are subject to the jurisdiction of the court.

Thus Section 62a alone or in conjunction with other provisions and principles allows an *affirmative* determination assessing costs of administration to certain interested parties. The more important and eminently protective function of Section 62a, however, is to authorize the *negative* side of the determination; the court may refuse to saddle certain expenses upon the estate, irrespective of, and unconcerned about, who will ultimately bear their burden.

Collier on Bankruptcy, 14th Ed., Vol. 3, p. 1400.

These Proceedings Were Not a Suit Against the State.

Appellant's counsel, at page 11 of their opening brief, make the statement:

> "A state's immunity from suit without consent, either directly or through one of its duly constituted agencies is too well established to warrant discussion."

Citing as their authority for such principle, 49 Am. Jur. at pages 301, 304, and Willoughby on the Constitution of the United States, Vol. 3, 2nd Ed. (1929), commencing at page 1381, and at page 1396.

The general principle stated by counsel is enunciated in each of the texts at the pages cited, but also in each of said texts, a few pages further on we find exceptions which refer to the situation here presented and which cast a vastly different light upon counsels' positive assertion just quoted. At pages 310 and 311 of 49 Am. Jur. and at

page 1412 of Vol. 3 of Willoughby on the Constitution of the United States, it is noted that the acts of officials which are not legally authorized or which exceed or abuse the authority or discretion conferred upon them are not acts of the state and that a suit against such officials is not a suit against the state. Also there is clear authority to the effect that the Eleventh Amendment which denies to the citizen the right to resort to a federal court to compel or restrain state action, does not preclude suit against a wrongdoer merely because he asserts that his acts are within an official authority which the state does not confer.

Worcester County Co. v. Riley, 302 U. S. 292, 297;

Greene v. Louisville & I. R. Co., 244 U. S. 499, 506, 507;

Ex parte Young, 209 U. S. 150, 155.

The Federal Court's Jurisdiction Is Not Defeated by Prohibition of State Statute.

A state cannot, by statute inhibiting injunction to restrain collection of taxes, deprive federal equity courts of jurisdiction in proper cases to restrain such collection.

Skagit County, et al. v. Northern Pac. Ry. Co. (9th Cir., 1932), 61 F. 2d 638, 643.

Such a provision in the California Sales and Use Tax Law prohibiting an injunction could not be binding upon the Bankruptcy Court where it is necessary to prevent the defeat and impairment of its jurisdiction.

Steelman v. All Continent Corporation, 301 U. S. 278, 289, 57 S. Ct. 705, 81 L. Ed. 1085.

Also, the property of the bankrupt estate is in the custody of said court, and under its exclusive control.

Isaacs v. Hobbs Tie & Timber Co., 292 U. S. 734, 737, 738, 51 S. Ct. 270, 75 L. Ed. 645.

A Separate Suit for Injunction to Obtain Jurisdiction Over the Appellant Is Not Necessary.

Appellant complains at page 12 of its opening brief that neither the State of California nor the Board of Equalization was a party to the bankruptcy proceeding involving the West Coast Cabinet Works; that the Referee did not obtain jurisdiction by the service of the order to show cause upon the Board, and that jurisdiction could not have been obtained of the State or the Board without a separate suit being commenced "in the authorized manner."

The tax was an administrative expense.

Heyman v. U. S. (6 Cir., 1923), 285 Fed. 685;

McColgan v. Maier Brewing Co. (9 Cir., 1943), 134 F. 2d 385.

As has been heretofore stated herein, a demand for payment of an administrative expense (the tax in question) was presented to the Trustee, who in turn presented it to the Referee, who disapproved it, and who issued an injunction after a hearing, to prevent the defeat or impairment of his exclusive jurisdiction and to protect the property and assets of the bankrupt estate.

We quote from the case of *In re International Power Securities Corporation* (3 Cir., 1948), 170 F. 2d 309, at page 402:

> "Certain well established principles are applicable in the determination of the question as to jurisdiction.
>
> "They are: Courts of bankruptcy are invested with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings. *Local Loan Co. v. Hunt,* 1934, 292 U. S. 234, 240. They are empowered to issue an injunction in a summary proceeding when necessary to prevent the defeat or impairment of their exclusive jurisdiction or to protect the property and assets of a bankrupt wherever situated. (Citing in a note Section 111 of the Bankruptcy Act, 11 U. S. C. A. 511.) The power of a bankruptcy court to protect by injunction the subject matter of its jurisdiction is inherent in the court as a virtual court of equity and exists as well by virtue of Section 2, sub. a (15) of the Bankruptcy Act, 11 U. S. C. A., Section 11, sub. a (15), and the 'all writs' provision of Section 262 of the Judicial Code, 28 U. S. C. A., Section 377. (Revised Judicial Code, Title 28 U. S. C. A. 1651.)"

A Plenary Proceeding Was Not Necessary.

We do not believe it may be said that a separate proceeding, a plenary proceeding, was necessary to acquire jurisdiction of the Board of Equalization, but in any event, it is clear that the Board acquiesced in the Referee's jurisdiction over it, and participated in the hearing on the order to show cause, sought a review of the Referee's order, and participated in the proceedings before the District Court, all without raising the question of the juris-

diction of the Bankruptcy Court over Appellant, until after the Referee and the District Judge had decided adversely to Appellant on the merits.

The record indicates that it was understood by all counsel that the hearing before the Referee was the first step toward a decision on the Questions involved by a higher court.

See the Referee's remarks. [Tr. 50.]

That the Board had no objection to the jurisdiction over it of the Referee, and to his determination of the questions involved is also made clear by the following remark of counsel for the Board at the hearing on the order to show cause. [Tr. 70.]

> "May I say this, that if we cannot get our evidence into the record we obviously will have to wait until we can go before another Referee who will permit the introduction of this testimony."

(The testimony mentioned was admitted by stipulation and added by an amended certificate after the Petition for Review was filed).

Expedition in Administration of the Estate Is Required.

To close up the estate "as expeditiously as is compatible with the best interests of the parties in interest" is a duty of the trust required not only by clause (1) of Section 47a, but also by implication from other provisions found in the Act and the General Orders. A trustee who unduly delays settlement of the estate has been held not entitled to interest on advances made to pay expenses of administration; and where such delay is due to the in-

efficiency of the trustee, he should be removed from office. If a loss results because of the neglect of the trust to act expeditiously, he may also be surcharged with the amount of such loss.

In *Rife v. Ruble,* 41 A. B. R. (N. S.) 543, 107 F. 2d 84, the court said:

> "While a bankruptcy trustee is undoubtedly charged with the duty of preserving property which comes into his custody, including that of claimants whose claims he may in the exercise of a reasonable judgment oppose, yet he is also charged with the duty of expeditiously liquidating the estate and avoiding all unreasonable expense either in its preservation or distribution."
>
> Collier on Bankruptcy, 14th Ed., Vol. 2, p. 1745.

The State Law Did Not Afford the Trustee Herein a Plain, Speedy and Efficient Remedy.

The cases cited by Appellant at page 14 of its opening brief, *Nevada-California Electric Corp. v. Corbett,* 22 Fed. Supp. 951, and *Corbett v. Printers and Publishers Corp., Ltd.,* 127 F. 2d 195, are not decisive as to whether the trustee involved herein had a plain, speedy and efficient remedy at law for the reason that those cases involved corporations. In order for the trustee to have brought suit for refund he must have followed the steps prescribed by the Law to precede the bringing of his action, and beforehand must have paid the tax out of funds which constituted assets of the bankrupt estate under the exclusive control of the Bankruptcy Court.

With reference to Appellant's argument that Appellee has a speedy and adequate remedy under the state law, it

might better be said that Appellee has a *remedy only,* because a careful analysis of the provisions of the law pertaining to refunds will demonstrate that the remedy is neither *speedy* nor *adequate.*

The California Sales and Use Tax Law provides as follows:

> "Section 6932. Claim for refund or credit as condition precedent. No suit or proceeding shall be maintained in any court for the recovery of any amount alleged to have been erroneously or illegally determined or collected unless a claim for refund or credit has been duly filed pursuant to Article 1 of this chapter."
>
> "Section 6561. Right to petition for: Time to file petition. Any person against whom a determination is made under Articles 2 or 3 of this chapter or any person directly interested may petition for a redetermination within 30 days after service upon the person of notice thereof. If a petition for redetermination is not filed within the 30-day period, the determination becomes final at the expiration of the period."
>
> "Section 6902. Claim for refund: Necessity for: Time to file. No refund shall be allowed unless a claim therefor is filed with the board within three years from the fifteenth day after the close of the quarterly period for which the overpayment was made, or, with respect to determinations made under Articles 2 or 3 of Chapter 5 of this part, within six months after the determinations become final, or within 60 days from the date of overpayment, whichever period expires the later. No credit shall be allowed after the expiration of the period specified

for filing claims for refund unless a claim for credit is filed with the board within such period."

"Section 6933. Time to sue: Venue of action: Effect of delay. Within 90 days after the mailing of the notice of the board's action upon a claim filed pursuant to Article 1 of this chapter, the claimant may bring an action against the board on the grounds set forth in the claim in a court of competent jurisdiction in the County of Sacramento for the recovery of the whole or any part of the amount with respect to which the claim has been disallowed.

"Failure to bring action within the time specified constitutes a waiver of any demand against the State on account of alleged overpayments."

Note: Appellant refers to the 1947 Amendment to the last section, which permits suits in counties of Sacramento, San Francisco and Los Angeles. This amendment was not in effect at the time of the trial.

Even under the 1947 amendment, trustees and receivers operating in the State of California (and there are many outside of the three counties) would have to travel to one of these points to try their suit against the Board of Equalization. A trial might involve an appeal, a petition for rehearing, a petition for hearing in the Supreme Court, which could conceivably project itself into years of litigation. We respectfully contend that the only adequate and speedy remedy available to receivers and trustees is the summary jurisdiction of the Bankruptcy Court in determining the legal liability for the taxes imposed.

A Three Judge Court Was Not Required.

The petition for order to show cause filed by the trustee which initiated the proceedings prior to this appeal did not raise a constitutional issue; no finding or conclusion concerning the constitutionality of the statute involved was made by the Referee; the petition for review filed by the Board made no mention of a constitutional question, and the District Court in its Opinion, Findings of Fact and Conclusions of Law did not consider the constitutionality of the state law involved.

With Reference to Part II of Appellant's Opening Brief.

Pages 21 to 49, inclusive, of Appellant's Opening Brief, are devoted exclusively to a page by page criticism of the opinion below. The only practical way to demonstrate the fallacy of counsel's criticism is to refer to the opinion itself, and it would do little good for us to set forth at length here what the opinion states. Suffice to say that if the opinion is studied in conjunction with the notes appended thereto, counsel's argument is more accurately answered than with any language that we could employ.

By way of example, on page 37 of Appellant's Opening Brief, the statement is made that the opinion concludes "that the California Sales Tax cannot constitutionally be imposed upon trustees in bankruptcy in connection with liquidation sales made by them." Commencing on page 653 of the reported opinion it is observed:

> "It is not our thought that for the purpose of a decision on the matter before us we are required to pass upon the constitutionality of the California law under consideration as applied to the trustee before us; . . ."

Again on page 47 of Appellant's Opening Brief it is stated:

> ". . . Erroneously assumed, again, is the proposition that compliance with the California Sales and Use Tax Law by appellee would have resulted in interference with the bankruptcy court's control over appellee's activities and the property in its custody."

Starting at page 656 of the opinion, a complete discussion is had of all of the provisions of the Law which would constitute interference with the orderly and expeditious administration of the estate. Among these provisions are those such as obtaining a permit, for which the Board, may, if it sees fit require that security be deposited. Should this amount be fixed in an amount greater than the estate can furnish, or should the estate have no cash assets and no security which could be deposited, a permit could not be issued, and the trustee would, on peril of being imprisoned for a violation of the act, sell the assets, or refrain from selling such assets and violate the plain mandate of the Bankruptcy Act to dispose of the assets as expeditiously as possible. Too, if at any time the Board is not "satisfied" that the retailer will pay the tax when due, it may demand additional security; should the Board believe the retailer will not pay the tax after a deficiency is shown, it may "freeze" the security, thus interfering with the control of the assets by the Bankruptcy Court, and delaying the administration of the estate. Further provisions make it mandatory that the trustee file returns quarterly or at more frequent periods if decreed by the Board; the provision for quarterly payment, or for payment at more frequent intervals would result in the State being paid in full at the expense of

other administration creditors whose claims may not yet have accrued, such as the trustee, the attorneys for the bankrupt, and perhaps others who have assisted in conserving the estate. The provisions above enumerated do not constitute the total of those mentioned in the opinion as serving to withdraw from the Bankruptcy Court the control of the bankruptcy estate, but are sufficient to negative the premise on which the Appellant bases his contradiction of the conclusion of the opinion in this regard.

JUDICIAL SALES.

In the court below, Appellee earnestly contended that judicial sales in any event could not be subject to the provisions of the California Sales and Use Tax Law, and although the lower court decided the issue on the theory of the line of cleavage between conducting the business and liquidating, and upon the further theory that the trustee when liquidating was not engaged in business and was not included in the definition of the statute defining "persons," it is respectfully contended that during any liquidation in bankruptcy all sales are *judicial sales.*

Sales in bankruptcy other than in the course of operating the business are *judicial* sales. In judicial sales the court is the real seller and the trustee but its agent to obtain the highest bid; the trustee cannot pass title and no title is vested in the purchaser until an order confirming the sale is made by the court.

American Bottle Company v. Finney, 203 Ala. 92, 82 So. 106, 43 A. B. R. 685;

Robertson v. Howard, 229 U. S. 254, 57 L. Ed. 1174, 38 S. Ct. 854, 30 A. B. R. 611;

In re Burr Mfg. Company, 217 Fed. 16, 32 A. B. R. 708 (C. C. A. N. Y.);

Moccasin State Bank v. Waldron, 81 Mont. 579, 12 A. B. R. (N. S.) 1;

In re D. T. Bohan Co., 22 Fed. Supp. 561, 34 A. B. R. (N. S.) 105 (D. C. Ky.);

Stang v. Hadden, 26 Fed. 11;

In re Glas-Shipt Dairy Company, 239 Fed. 122, 38 A. B. R. 554 (C. C. A. Ill.);

In re Virgin, 16 A. B. R. (N. S.) 314 (Ref. Pa.);

In re United Toledo, 152 F. 2d 210, 1945 (C. C. A. 6, Ohio);

In re Wolke Lead Batteries Co., 294 Fed. 509, 2 A. B. R. (N. S.) 630 (C. C. A. Ky.): "While the highest bidder for property offered for sale by a Trustee in bankruptcy is entitled to have his bid accepted by the Trustee and reported for confirmation (*In re Williams,* 197 Fed. 1, 28 A. B. R. 258), yet he is not the purchaser and is not vested thereby with even an equitable title in the property until the sale is confirmed."

By the act of confirmation, the sale becomes complete and the title passes.

In re Finks, 224 Fed. 92, 34 A. B. R. 749 (C. C. A. Ohio).

And it is just as much a judicial sale where the court simply approves an offer made, as where it first orders a sale and thereafter approves an offer.

In re Jungmann, 186 Fed. 303, 26 A. B. R. 401 (C. C. A. N. Y.);

In re Harvey, 122 Fed. 745, 10 A. B. R. 567, 568 (D. C. Pa.).

We are not herein concerned with judicial sales in the broad sense, but rather judicial sales conducted by receivers and trustees in *bankruptcy*. These sales must be interpreted and governed by the decisions of the Federal Courts and the Federal Courts are not concerned in this instance with an interpretation of a State Court in construing a statute applicable to a citizen of that state in a State Court proceeding, or a transaction involving state officials and private individuals.

There is nothing in the law which permits or suggests the licensing of an agent of a Retailer, and the Trustee being the agent of the court could not be licensed in selling tangible personal property in judicial sales.

The California Sales and Use Tax Law contains the following provisions:

Section 6051:

"For the privilege of selling tangible personal property at retail a tax is imposed upon all retailers . . ."

Section 6015—"Retailers" includes:

"(a) Every person engaged in the business of making sales at retail or in the business of making retail sales at auction of tangible personal property owned by the person or others.

"(b) Every person engaged in the business of making sales for storage, use, or other consumption or in the business of making sales at auction of tangible personal property owned by the person or others for storage, use, or other consumption.

"(c) Any person conducting a race meeting under the provisions of Chapter 769, Statutes of 1933, as amended, with respect to horses which are claimed during such meeting . . ."

Section 6066:

"Every person desiring to engage in or conduct business as a seller within this State shall file with the board an application for a permit for each said place of business . . ."

Section 6068:

"After compliance with Sections 6066, 6067, and 6071, by the applicant, the board shall grant and issue to each applicant a separate permit for each place of business within the state . . ."

Section 6071:

"A person who engages in business as a seller in this state without a permit or permits, or after a permit has been suspended, and an officer of any incorporation which so engages in business, is guilty of a misdemeanor . . ."

If it were held that a receiver or trustee in bankruptcy selling tangible personal property at judicial sales is required to procure a license in accordance with the above provisions and failed so to do, how would the State Agency enforce the penal provisions of the Law? Most

assuredly not against the court, and the law does not denounce the act of any person for failure to comply with the law except a person engaged in business as a seller. (Sec. 6071.)

For the foregoing reasons, the order below should be sustained.

Respectfully submitted,

LESLIE S. BOWDEN,

Attorney for George T. Goggin, Trustee in Bankruptcy of the Estate of West Coast Cabinet Works, Inc., Appellee.

No. 12727

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

CALIFORNIA STATE BOARD OF EQUALIZATION,

Appellant,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of West Coast Cabinet Works, Inc.,

Appellee.

AMICUS CURIAE BRIEF.

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AMICUS CURIAE BRIEF.

This Court has made an Order permitting the within brief to be filed herein by the undersigned as *Amicus Curiae.*

We are likewise permitted to so join in the proceedings before the District Judge.

The problem presented herein is of great interest to us far beyond the academic interest which we have in the determination herein, inasmuch as we represent various trustees and receivers in bankruptcy who are currently confronted with the same problem.

It is our firm opinion that the question of whether or not the state agency could affix a sales tax to bankruptcy liquidation sales was definitely settled by this Honorable Court in the case of *State Board of Equalization v. Boteler,*

131 F. 2d 386 (affirming decision of U. S. District Judge Ben Harrison in *Davis Standard Bread Co.,* 46 Fed. Supp. 841).

In the case at bar the record shows that the trustee in liquidating the assets of the bankrupt estate sold five automobile trucks to five separate individuals pursuant to the Order Confirming the said sales of the Referee. The State Board of Equalization attempted to assess the trustee with a sales tax thereon.

Upon a hearing in which an injunction was issued, the Referee in Bankruptcy, before whom the said estate was being administered, determined that the sales were not made by the trustee in the course of conducting the business of the bankrupt and that the trustee was not liable for any sales tax.

Statements of Facts.

We set forth as the Statement of Facts herein the following, which is taken verbatim from the Opinion of the District Judge:

> "The bankrupt herein, West Coast Cabinet Works, Inc., a corporation, was engaged in the business of manufacturing and selling cabinets and filed sales tax returns and paid sales tax under the California Sales and Use Tax Law. On February 5, 1946, the corporation filed a petition under Chapter XI of the Bankruptcy Act, and George T. Goggin, as receiver of the debtor was authorized to conduct the business and sell the same as a going concern; he applied to said Board for, and was granted a seller's permit to engage in the business of selling tangible personal property, and during a period of a little over a month completed certain orders which the debtor had

on hand, sold the completed articles and paid sales tax on his retail sales as provided in said Sales and Use Tax Law.

On March 12, 1946, the West Coast Cabinet Works, Inc., was adjudicated bankrupt, and George T. Goggin as the appointed trustee was authorized to conduct the business of the bankrupt. As trustee in bankruptcy, Goggin applied for and was granted a permit to engage in the business of selling tangible personal property.

The evidence shows that between March 12, 1946, and March 22, 1946, in conduct of said business, the trustee made sales at retail and also sales for resale, and paid sales taxes. No tax is claimed by the Board to be due for such period.

On March 22, 1946, he was directed by order of the Referee to sell the assets of the estate either at public auction or private sale.

Subsequent to the order to sell in liquidation, the trustee, in addition to various sales for resale, made at least twenty sales which were listed on his books as sales at retail; on ten of the twenty sales the trustee 'collected sales tax reimbursement'; sales tax was reported and paid on all sales except certain sales made on March 29, 1946, as hereinafter set forth.

On said date last mentioned, the trustee sold, at public auction, in open court, and subject to confirmation of court, five trucks which had been used by the bankrupt in the conduct of his business for deliveries; each of said five trucks was sold to a different person; no 'sales tax reimbursement' was collected; the sales were confirmed by the court; the amounts received from such sales were not included in any sales tax return.

The Board made an additional determination of taxes due basing said assessment upon the gross receipts from the sales of the five trucks; notice of such assessment was mailed to the trustee, no petition for redetermination was filed within 30 days thereafter, whereupon a penalty of 10% was added by the Board to the amount of the tax.

The trustee petitioned for an injunction, and after a hearing before the Referee the order here sought to be reviewed was made. In said order, the Referee found that the sales of the five trucks were not made by the trustee in the course of conducting the bankrupt estate, but were made under court order in the normal administration of the estate in liquidating the assets for the benefit of creditors, subject to the confirmation of court and that the trustee was not liable to the Board for sales tax based upon said sales, and that the Board was attempting to enforce payment of the tax claimed."

Taxes Payable Upon Operation of Business.

In order that the problem be reduced to its simplest form we desire to take out of the present controversy all question pertaining to the various taxes, including Income Tax, Sales Tax, License Tax, etc., as may arise and be charged to a receiver or trustee in bankruptcy "who is authorized by the court to conduct any business, or who does conduct any business" with the admission that from and after June 18, 1934, "the said receiver and/or trustee shall be subject to all state and local taxes applicable to such business the same as if such business were conducted by an individual or corporation." The above quotation appears in the original Section 124a passed

June 18, 1934. Its present context as transferred into Section 960 in Title 28 U. S. C. A. (revised 1948), provides:

> "Any officer or agent conducting any business under authority of a United States Court shall be subject to all Federal, State and Local taxes, applicable to such business to the same extent as if it were conducted by an individual or corporation."

We strongly urge that when Congress passed Section 124a thereby "consenting" to place the tax burden upon the receiver and trustee when they operated the business that correspondingly there was a withholding of the right to tax the bankruptcy process, *i. e.,* the trustee's liquidation of assets.

If the taxing agency by the said section gained the right to tax when the business was operated, which right it admittedly did not have before, did it gain more? Was it accorded the right to interfere with the bankruptcy administration and the right to tax the very essential segment of bankruptcy administration, *i. e.,* liquidation of assets into cash for distribution to creditors. In Congress alone, under the Constitution, is vested the right to legislate upon the subject of bankruptcy. (Const., Sec. 8, Art. 1.)

As was recognized by the Supreme Court of California in *Fifth Street Building v. McColgan,* 119 F. 2d 729, *supra,* page 730,

> "Congress creates the trusteeship, fixes the conditions of its existence and may provide, as in the Act of 1934, that (where the trustee operates the business) a trustee be of such a nature as to come within the range of the state tax laws."

Congress has not seen proper to fix upon a trustee the "nature" of a seller or retailer, or to state that his duties under the Act in regard to selling in liquidation, after adjudication and under order of Court shall be regarded the same as if a private person or corporation was in the process of performing such acts.

In *In re California Pea Products,* 37 Fed. Supp. 658, *supra,* at page 661, it was stated:

> "The adjudication was ordered under Section 236 of the Bankruptcy Act, 11 U. S. C. A. 636, and the functions of the trustee in relation to the questioned sales were those and only those, prescribed in Section 238 of the Bankruptcy Act, 11 U. S. C. A. 638. In exercising such functions the trustee does not in the ordinary meaning of the term conduct any business."

The Court also ruled that the law did not specify a "trustee in bankruptcy" within the definition of person, and held that the referee in bankruptcy was correct in holding that the trustee there involved was not "one of the persons mentioned in the act as being engaged in the business of selling tangible personal property at retail" and even though the section of the California Statute was thereafter amended it still does not include "trustee in bankruptcy."

In *In re Davis Standard Bread Co.,* 46 Fed. Supp. 841, *supra,* the District Judge stated at page 842 that the trustee selling in liquidation, after adjudication and under order of Court was not engaged in the business of selling tangible personal property at retail within the meaning of the said law.

State Board of Equalization v. Boteler, 131 F. 2d 386, *supra,* at page 388, in affirming the decision in the *Davis*

Standard Bread case, held that the trustee was not engaged in the business of making sales at retail of tangible personal property.

The holdings of the three cases in our Ninth Circuit to the effect that the trustee was not engaged in business under the sales tax provisions of the law *were made separate and apart from any consideration of the fact that the law at that time did not include "trustee"* within the definition of person, and we are not persuaded that such rulings lose any weight by reason of the amendment. It is to be observed that the definition of "business" was the same then as it was when the trustee herein is claimed to have been liable under the law.

It is also to be noted that in each of the three decisions, the Court ruled that the trustee in carrying out his liquidation functions was not "conducting" any business within the meaning of 124a.

Little difficulty need be encountered in arriving at a determination as to when and under what circumstances a receiver or trustee is "conducting the business."

In re California Pea Products, 37 Fed. Supp. 658 (D. C. So. Cal.), decision by Judge Paul J. McCormick;

In re Davis Standard Bread Co., 46 Fed. Supp. 841 (D. C., So. Cal.), decision by Judge Ben Harrison;

State Board of Equalization v. Boteler, 131 F. 2d 386 (9th Cir.), affirming *In Re Davis Standard Bread.*

In these cases the determination was that the trustee was not operating the business and that Section 124a had no application and further that the trustees' liquidation sales were not taxable.

On the other hand, the cases of *Boteler v. Ingles,* 308 U. S. 57, and *United States v. Metcalf, Trustee,* 131 F. 2d 677 (9th Cir.), point out the applicable situation wherein the business is operated.

In order to bring the trustees' liquidation sales in for sales tax purposes, counsel for the appellant in his presentation before the District Court argued that the trustee should be considered as "conducting a business" when he acts as trustee in a number of cases at the same time and makes liquidation sales in each, *i. e.,* that he is conducting the business of being a trustee in bankruptcy and that his various trust positions should be aggregated and thus be charged with conducting "businesses" of a trustee in bankruptcy and therefore taxable under Section 124a. However, this specious argument was immediately rejected by the District Judge.

Likewise there appeared no basis for the "bridging over" argument by counsel for the appellant that the trustee once having been authorized to conduct the business could not terminate the operation and revert to the primary duty of liquidation of assets so as to distinguish operation of business sales from normal liquidation of asset sales. The District Judge said:

> "In the instant case, we do not believe that the fact that the assets sold by the trustee had been utilized by the bankrupt, the receiver, the trustee in bankruptcy or any one of them in the conduct of a business had any materiality in the case before us. Section 47a of the Bankruptcy Act, 11 U. S. C. A. 75a

by its terms charges the trustee with the primary duty of collecting and reducing to money the property of the estate; conducting the business is not a duty of a trustee as a matter of course, but a duty which may be imposed upon him by order of court, under Section 2(5) of the Bankruptcy Act, 11 U. S. C. A. 11(5), when such court, in the exercise of its discretion, determines such procedure to be 'necessary in the best interests of the estates.' (In re Weiner, 7 F. Supp. 691, aff'd 72 F. (2d) 1010.)

It is our view that after adjudication, when such conduct of the business has been authorized by the court, a subsequent order to sell in liquidation marks the termination of such authority, as well as the termination of the business, and is the line of cleavage between conducting the business and liquidating it. A trustee cannot then be considered as 'conducting the business of the bankrupt' within the meaning of Section 2(5) of the Bankruptcy Act, 11 U. S. C. A. 11(5), nor as 'conducting any business' within the meaning of Section 124a of Title 28, U. S. C. A., and any status such trustee may have been given by virtue of 124a as an 'individual' or 'corporation' conducting any business, is no longer to be attributed to him.

Likewise, we do not believe that the fact that the same individual, George T. Goggin, was the receiver who conducted the business, the trustee in bankruptcy who conducted the business, and the trustee in bankruptcy who sold assets of the bankrupt estate after adjudication under order of court in liquidation, has any materiality here. At no time, acting under the orders of the court, could George T. Goggin have acquired any personal status as a retailer by virtue of the acts performed under such orders."

Taxing Statutes.

The opinion of the District Judge summarizing the law and its development is as follows:

> The Sales and Use Tax Law of California is found in the Revenue and Taxation Code of said State. Division 1 relates to property taxation. Division 2 refers to ten other types of taxes, namely: Part 1, Sales and Use Taxes, Sections 6001 to 7176, and Parts 2 to 10 inclusive contain, respectively, sections relating to Motor Vehicle Fuel Tax, Use Fuel Tax, Motor Vehicle Transportation License Tax, Vehicle License Fee, Private Car Tax, Insurance Taxation, Inheritance Tax, Gift Tax, Personal Income Tax.
>
> Most of the provisions of the present law relating to sales tax were taken from similar provisions found in the Retail Sales Act of 1933, as amended in 1935, 1937, 1939 and 1941; the same is true of the provisions relating to use tax, which were based upon provisions of the Use Tax Act passed in 1935, and subsequently amended. In 1941, effective in 1943, the California Legislature combined most of the provisions of the two acts and the same were reenacted as the present Law and made a part of the Revenue and Taxation Code of the State of California as hereinbefore mentioned. Further amendments were made to some of the sections relating to either or both of the taxes in 1943, 1945, 1947 and 1949.
>
> Part 1 of Division 2 of the said Code "Sales and Use Tax Law" is divided into eleven Chapters. Chapter 1 contains definitions of various terms used in subsequent chapters, and Section 6002 of said chapter specifies that the definitions given in such chapter govern the construction of the Law except where the context otherwise requires; it is further stated

that by "sales tax" is meant the tax imposed by Chapter 2 of the Law, and by "use tax" is meant the tax imposed by Chapter 3 thereof.

Section 6005 defining "person" was originally Section 2 of the Retail Sales Tax Act of 1933, and read: "Person includes any individual, firm, copartnership, joint adventure, association, corporation, estate, trust, business trust, receiver, syndicate."

The Section was amended in 1935, 1937, 1939 and in 1941, to take effect in 1943, it was included as said Section 6005 of the Revenue and Taxation Code and from 1943 to 1945, the section included in its definition of "person" the following:

". . . any individual, firm, copartnership, joint adventure, association, social club, fraternal organization corporation, estate, trust, business trust, receiver, syndicate, this State, any county, city and county, municipality, district, or other political subdivision thereof, or any group or combination acting as a unit."

1945 Amendment.

In June of 1945, the section was amended to add the words *"trustee"* and "United States."

The District Judge in carefully analyzing the various provisions said in his Opinion:

"Section 6051 of Chapter 2 relating to sales tax recites, in part:

For the *privilege* of selling tangible personal property at retail a tax is hereby imposed upon all retailers at the rate of (3% after June 30, 1945) of the gross receipts of any retailer from the sale of all tangible personal property sold at retail in this State. . . .

Sections 6066, 6067, 6069, 6070 and 6071 have to do with the permit required by Section 6051 *for the privilege of selling tangible personal property at retail.* These provisions cannot be characterized as 'mere registration provisions to enable the State to know who is in business' as was explained with reference to the Arizona Occupation Tax in O'Neill v. United Producers Co-op., 1941, 113 P. 2d 645; these sections represent an integral part of the plan to secure collection of the taxes. There is a flat requirement for payment of a fee of $1.00 and the said sections place in the hands of the Board the *power to require security up to the amount of $10,000 as a condition to the issuance of a permit. A criminal penalty is imposed for selling without such permit,* after a hearing before it, *the Board may revoke such permit* for violation of any of the rules or regulations of the Board relating to the sales tax prescribed by the Board under the provisions of the Law; after such revocation, the permit may not be reissued until the Board is 'satisfied' that the taxpayer will comply with the Law and the regulations adopted by the Board.

Under Section 6796 it seems that the Board has authority at any time within three years after any person is delinquent in the payment of any amount, *to seize, without notice any property of the tax payer* and after notice to sell the same at public auction, and to hold the residue after the amount of the tax and penalties is satisfied for the claims of third parties. . . .

In addition to making it a misdemeanor to engage in business as a seller without a permit, the Law provides penalties for various other violations of the Law such as filing a false return, or *failing to fur-*

nish any data required by the Board; the maximum penalty prescribed being imprisonment for a year and a $5,000 fine."

The Appellant placed great weight upon the insertion by the California Legislature of the word "trustee" in the said taxing statute in 1945. At least, it was not until after this amendment when the Appellant opened up all of its guns in its attempt to collect the sales tax on bankruptcy liquidation sales.

To hold that the Legislature of California intended a trustee such as is here before us to be included within the definition of the word "person" as applied with reference to the sales tax provisions of said taxing statute, would be to imply that the Legislature intended the trustee here to be subject to none of the enforcement provisions which present a conflict with the Bankruptcy Act; this would result in an inconsistency between the section mentioning "trustee" and the enforcement provisions of said statute, or an emasculation of the law which would "deny the State the traditional and almost universal method of enforcing prompt payment" of the tax; or, we would be called upon to imply that the State intended to precipitate conflict or occasions for conflict between federal administration of the Bankruptcy Act and state administration of the Sales and Use Tax Law; or, that the State intended, in the absence of Congressional consent, to interfere with or to frustrate the execution of the powers conferred upon Congress by the Bankruptcy Clause of the Constitution.

We do not believe that the Legislature of California intended any of these obvious consequences as above mentioned. There are many persons, corporations or organ-

izations to whom the word "trustee" can apply consistent with all the provisions of the law, with the general purpose thereof, and without doing violence to the principles of statutory construction; *a trustee in bankruptcy, selling in liquidation, after adjudication and under order of the court is not one of them.*

Jurisdiction of the Bankruptcy Court Over Expenses of Administration.

If the trustee has incurred an obligation for sales tax as contended by the Appellant then the said charge is an "expense of administration."

Expenses of administration are payable under the provisions of Section 64a(1) (*i. e.,* the first priority) and thereafter the distribution follows (2) wages, (3) costs and expenses where confirmation of arrangement or discharge revoked or set aside, etc., (4) taxes legally due and owing by the bankrupt, (5) debts prior by the laws of the United States, and thereafter to general creditors.

In the administration of the bankruptcy estates before the Referee, the first order of payment upon distribution is those items in class (1), to-wit: the expense of administration. If a sales tax is owing by the trustee, as well as any other obligation incurred in the administration of the bankruptcy estate, it falls in this class.

There is no order of priority within the class. It is therefore imperative that the items of expense of administration must be ascertained, revealed and brought forward for the approval and order of payment by the Referee before the estate can proceed in distribution and before there can be payment to creditors, who were in existence at the date of bankruptcy.

If there is any such sales tax payable, it is an "expense of administration" under Section 62 and to be paid under Section 64a(1). In general bankruptcy practice the expense of the trustee's administration, to-wit: employment of adjusters, advertising, expense of sale, etc., is paid direct by the trustee and he reports the same to the Referee in his report and account, the approval of the report being the approval of the said disbursements. However, in disputed matters, including rental claims for occupancy of the premises by the trustee wherein there is usually a ground of disagreement, the said charge is reported to the Referee for payment. This follows, because the trustee does not want to be subject to surcharge in making payment in those matters wherein the Referee will not later authorize or approve the payment.

Thus in connection with sales taxes claimed upon liquidation sales of the trustee, the Referees have consistently held that those taxes cannot be paid. Parenthetically, we might observe that where the trustee operates and carries on the business, the said sales tax is paid without question. The Referees have made many orders in all known pending cases to the effect that the sales tax on trustee's liquidation sales of personal property cannot be paid.

Inasmuch as the bankruptcy court has jurisdiction over the distribution of its funds, it follows that the contended expense of administration, to-wit: the claim for the said tax may be "called in" before the Court. That is just what has been done in the instant case, wherein the said taxing agency has been requested to present to the bankruptcy court such claim or charge as it may have for the said sales tax. It is obvious that if the said claim is so presented that then and in that event the trustee will bring on appropriate objections thereto, placing the same in

issue and the trustee will contend that if the tax is so payable it be paid from the cash assets in the hands of the Court and being so paid (if finally ordered paid) the trustee will be protected in his individual capacity.

To turn now to the instant problem, we find the trustee ready to close the administration, and to distribute under the Order of the Referee the funds to the persons entitled thereto. This is a Court function, established by the Bankruptcy Act (Sec. 47A), and the one in which the creditors are most interested. In the present case the Referee during the administration had made Orders Confirming Sales of personal property. The questions then arose: 1. Should a sales tax be paid to the California State Board of Equalization upon the said liquidation sales? 2. What is the amount of the tax which should be paid? The trustee as aforesaid contended that there was no tax.

The demand by the Appellant against the trustee is most serious, especially the contention that the trustee could be held in his individual capacity therefore. The trustee herein, thereupon brought the matter before the particular Referee before whom the case was pending in administration.

The expense of administration in bankruptcy proceedings is dealt with under Section 62 which provides in part:

> "(a)(1) The actual and necessary costs and expenses incurred by officers, other than referees, in the administration of estates shall, except where other provisions are made for their payment, be reported in detail under oath, and examined and approved or disapproved by the Court. If approved, they shall be paid or allowed out of the estates in which they were incurred."

While this rule is statutory, there also is inherent jurisdiction given to any Court which administers the *res.* In other words, the funds in the custody of the Court, whether it be an equity receivership, corporate dissolution, a common fund in which many are interested, or a bankruptcy proceeding, being within the control and jurisdiction of the Court, may be chargeable by that Court with the expense of administration reduction to cash, cost of distribution, etc., thereof.

The same problem was presented in the case of *California Pea Products, Inc., 37* Fed. Supp. 658, upon almost the identical facts and it is interesting to note that in that case the provisions of the Bankruptcy Act (Sec. 62a(1)) were followed in bringing the matter before the District Court. An Order was made by Referee Ben E. Tarver at Santa Ana that the Board be restrained from proceeding against the said estate or L. Boteler, the trustee thereof, for the collection of the contended sales tax based upon liquidation sales made by the said trustee. A petition for review was filed to the Order of the Referee and the matter came on for hearing before Judge Paul J. McCormick of this Court. Quoting from portions of the Opinion of Judge Paul J. McCormick:

> "The Referee's order and injunction are attacked solely upon two grounds: (1) that said trustee in bankruptcy, L. Boteler, was selling on behalf of the bankrupt California Pea Products, Inc., machinery and equipment at retail within the contemplation of the California Retail Sales Tax Act, and that an injunction against the State Board of Equalization will not lie for the reason that the *said trustee in bankruptcy has under the California Retail Sales Tax Act an adequate remedy at law by paying the tax and suing to recover.*

Preliminarily, it is pertinent to observe that the petition for review originally contained a statement that the State Board of Equalization had filed in this bankruptcy matter its claim for sales tax due the State of California, and a part of the prayer of the petitioner on review was that this court on the review overrule any objections to said claim of the State Board of Equalization and allow said claim in full. By interlineations appearing upon the original petition for review, the aforesaid matters are stricken and are therefore not now a part of this review. *It thus does not appear that the State Board of Equalization has filed any claim for retail sales tax or in fact for any other tax in this bankruptcy proceeding,* or that an extension has been granted for the filing of any such tax claims.

In view of such situation, it is unnecessary on this review to go farther than to determine the validity and proper scope of the injunctive order issued by the referee. And until a claim for taxes is filed in this bankruptcy proceeding by the state authorities, *or until a 'bar order' is operative upon the state agency,* the question as to whether the trustee in bankruptcy in selling tangible personal property in liquidation of the bankrupt estate is a retailer and a person obligated to comply with the provisions of Act 8493 of the General Laws of the State of California is not properly before us.

It is, however, clear from the documentary evidence sent up with the referee's certificate that the State Board of Equalization had determined that the trustee was '*engaged in the business of selling tangible personal property, the receipt from retail sale of which are subject to the sales tax,*' and that such trustee was 'required by the California Retail Sales Tax Act' to secure a permit under the Act. Ac-

cordingly, *demand* was made by the state board for the *permit fee* provided in the act, and also that the trustee file quarterly returns in accordance with the Act under a likelihood or implied threat of being penalized for noncompliance with the demands of the state board, *and possibly of being sued in the state court for non-payment of taxes,* or at least of encountering some interference by the state board in the administration of this bankrupt estate. The probability of such an eventuality justified the referee in making an appropriate stay order. Section 2(15) Chandler Act. The possession of the property by the trustee is the court's possession, and any act interfering with the court's power of control and disposal and done without the court's sanction is void. Dayton v. Stanard, 241 U. S. 588.

The record shows that the trustee was not authorized by the bankruptcy court to conduct business under the permissive provisions of the bankruptcy act. Section 2(5) U. S. C. A. In fact, no application of any kind was made to carry on or to conduct business. On the contrary, *all of the selling activities of the trustee in bankruptcy were purely liquidating functions and in no proper sense should be considered in any other category.*

The tax claims referred to in sections 57(n) and 64(a) may be regarded as relating to matters and activities which have occurred *prior* to the filing of the petition in bankruptcy. The transactions upon which the state bases its contention in this review have all taken place *after* adjudication and the selection of the trustee in bankruptcy. The claims may therefore be considered as not strictly 'claims' against the estate within the contemplation of sections 57n and 64a, *but rather an expense of administration provided for in section 62 of the Act. But the same power*

of adjudicating such 'claims,' is vested in the bankruptcy court by section 62 as in the matter of tax claims under sections 57n and 64a.

The Supreme Court in Kalb v. Feuerstein, 308 U. S. 433, speaking of the broad and plenary power of courts of bankruptcy said, 'The Constitution grants Congress exclusive power to regulate bankruptcy and under this power Congress can limit the jurisdiction which courts, state or federal, can exercise over the person or property of a debtor who duly invokes the bankruptcy law.' See, also, Arkansas Corporation Commission v. Thompson, 116 F. (2d) 179 (C. C. A. 8th Cir.).

When a general reference has been made by the judge to a referee, as in this matter, he is, under the Chandler amendments to the Bankruptcy Act and under new General Order 12, *invested with complete jurisdiction of the proceedings,* and the Referee under such reference can do everything that the district judge can do, except certain specific powers which are reserved to the judge, but which are immaterial to this review or to the acts of the referee under consideration in this matter, under the factual situation shown by the record before us. See In re Munson, 11 F. Supp. 564.

We think, however, that the injunction and order under review is too broad. Mention has earlier been made of the modified and restricted scope of this review as shown by the interlineations on the petition for review, and although the briefs of the attorneys seem to assume that the record before us is sufficient and adequate to support a ruling determinative of a specific tax claim by the state board, no such claim has in fact been presented. There is, therefore, no basis for an injunction which so operates to *pre-*

clude the state board from presenting and filing a claim and having the same heard, considered and allowed or rejected by the referee as the situation may warrant.

Section 2(15) of the Bankruptcy Act empowered the referee to 'make such orders, issue such process, and enter such judgments,—as may be necessary for the enforcement of the provisions of this title, (act); provided, however, that an injunction to restrain a court may be issued by the judge only.' This statute, as well as General Order 12, effective February 13, 1939, is a rule of procedure relating to the remedy, and is applicable to this bankruptcy matter, and particularly, to the injunction herein which was issued March 22, 1940. And in arriving at the extent of power that is conferred upon the referee by section 2(15), the concluding clause of the subsection is a clear investiture in the referee under a general reference to issue all injunctions in the course of the bankruptcy proceeding necessary to prevent the defeat or impairment of his jurisdiction except that only a judge can enjoin a court. It would have been a simple matter for Congress to have made the prohibition against the referee's power to issue injunctions general if such had been the legislative intent. As no such intent appears but, on the contrary, only a single specific prohibition being shown, the referee is in all other instances vested with plenary judicial power to issue stay orders when acting under a general reference. See Collier on Bankruptcy (14th Ed.), Vol. I, page 277.

We conclude by holding that the findings, injunction and order of the referee, dated March 22, 1940, are modified as follows: The State Board of Equalization of the State of California, its officers, agents, employees and attorneys are, and each of them, is,

enjoined and restrained from in any manner enforcing or attempting to enforce any claim, tax, assessment, collection, penalties or sanctions provided in or pursuant to Act 8493 of the General Laws of the State of California against the estate of California Pea Products, Inc., a corporation, bankrupt, or against the trustee thereof, *or against L. Boteler, personally,* or against any property of said bankrupt, or of L. Boteler, or from in any manner interfering with the administration of this estate, without prejudice, however, to the *presentation and filing of any claim for taxes by the State Board of Equalization of the State of California,* its accredited and authorized officers, agents or attorneys, within the time allowed by law, and to having such claim considered by the referee *and its legality and validity determined by him, or without prejudice to a 'bar order' of the Referee."* (Italics ours.)

This Court in the case of *McColgan v. Maier Brewing Co.,* 134 Fed. 385 (9th Cir., March 10, 1943), determined that a state tax claim which arose during the pending bankruptcy proceeding was not a "provable debt" under Section 63 but was an expense of administration *and when not presented to the bankruptcy court during the administration thereof was barred.* From the opinion:

"The taxes accruing as a consequence of the operation of the business by the receivers were expense of administration. Remington on Bankruptcy, Vol. 2, p. 231; Heyman v. United States, 6 Cir., 285 F. 685; Hammond v. Carthage Sulphite Pulp & Paper Co., 2nd Cir., 8 F. (2d) 35; Central Vermont Ry. Co. v. Marsch, 1st Cir. 59 F. (2) 59; Prudential Ins. Co. v. Liberdar Holding Corporation, 2nd Cir., 74 F. (2d) 50; People of State of Michigan v. Michigan Trust Co., 286 U. S. 334, 52 S. Ct. 512,

76 L. Ed. 1136. They were not provable debts owing by the corporation itself, but were obligations of the receivership. In respect of the payment of administrative expenses, the statute (11 U. S. C. A. Section 102, sub. a) provides that unless other provisions for their payment are made they shall be 'reported in detail, under oath, and examined and approved or disapproved by the court. If approved, they shall be paid or allowed out of the estates in which they were incurred.' No other provision was made for the payment of these expenses. Thus the liability of the estate was dependent upon their being reported and their payment directed by court order."

Likewise in the case above referred to hereinabove (*State Board of Equalization v. Boteler*) the 9th Circuit in passing upon the action of the lower Court, which called in the state taxing agency for a determination of its alleged tax claim against the administration of the bankrupt estate, approved the determination of the lower Court and ratified not only its power of ascertainment but also its power of injunction. The Court said:

"The trustee filed with the Referee in Bankruptcy a petition for an order restraining the Board of Equalization from attempting to collect this tax.

The Referee granted the injunction, which was affirmed upon review by the District Court.

He did not continue the bankrupt's business in any sense, but instead chose to dispose of the physical equipment in accordance with his duty in such manner as to realize the highest return for the estate he was administering. Section 47, sub. a of the Bankruptcy Act, 11 U. S. C. A. Section 75, sub. a. In our opinion the fact that these assets had previously been

utilized by the bankrupt in the conduct of a business no longer in existence has no materiality in the case. His activities did not render him taxable under the terms of the California Retail Sales Act."

As a further indication of the all inclusive power of the bankruptcy court to control the distribution of the funds in the bankrupt estates reference is made to the established practice (prior to the 1938 amendment of the Bankruptcy Act) of "bar orders" to bring in for filing and consideration of the bankruptcy court all tax claims owing by the bankrupt at the time of bankruptcy.

Remington on Bankruptcy, Vol. 2, Section 798, in discussing "bar orders" states:

"Prior to June 22, 1938, there was no provision in the Act making it obligatory for the United States, the states and subdivision thereof to file proofs of claim. Accordingly, a practice arose of entering bar orders, fixing a time within which the claims of governments should be filed. The 'bar order' technique in respect to tax claims was a natural development. It was designed to accomplish two objects, to remedy two weaknesses evident in the application of the general rule that the United States was entitled to file its claim for taxes at any time during the pendency of a bankruptcy proceeding and before distribution of the estate. It was developed, first, to permit an uninterrupted expeditious administration of the bankrupt's estate, and, second, *to protect the trustee of such estate from liability to tax claimants in distributing assets in the course of his administration thereof.* 'The technique is an extension of the policy followed in equity receiverships and has been considered in much detail in the second circuit. *In re* Swan, 82 F. (2d) 160.

In determining the legality and priority of tax claims, the Bankruptcy Act is paramount over other federal and state statutes. The bankruptcy court makes an independent determination of the validity of taxes in order to determine to what extent proofs for taxes should be allowed. It is not bound by the determination of administrative boards.' "

Excerpts From Brief Filed in State Board v. Boteler.

We quote hereinafter portions of the Brief which we filed with this Court upon behalf of L. Boteler, Trustee, Appellee, in the case of *State Board of Equalization v. Boteler,* 131 F. 2d 386, because we believe that what we said to the Court there is equally in point in the instant case.

"This case (State Board of Equalization of State of California vs. L. Boteler, Trustee) stripped down to essentials, simply resolves itself into two questions:

1. Has the State of California, or any other State in the Union, the right to project itself into the administration of bankrupt estates, a field reserved entirely to Congress, and to require officers of the United States District Court to take out licenses permitting them to convert the bankrupt's assets into cash and then to impose a tax on the proceeds of such judicial sales?
2. Has the United States District Court the power and jurisdiction to protect its own officers from such illegal encroachment upon their duties and prerogatives as is here sought to be inflicted by the State of California?

Under Section 8, Article 1, of the Constitution of the United States, Congress is given the sole and exclusive power to 'establish uniform laws on the sub-

ject of bankruptcies throughout the United States.' Acting under this grant of power Congress enacted the National Bankrupt Act which defines, among other things, the jurisdiction of the United States District Courts in bankruptcy matters and the rights and duties of a trustee thereunder.

Section 2 of the Bankruptcy Act (11 U. S. C. A., Sec. 11), confers jurisdiction on United States Courts, among other matters, as follows:

Subdv. (15). 'Make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this Act; provided however, that an injunction to restrain a court may be issued by the judge only.'

Subdv. 21-b of Section 2 expressly provides:

'Nothing in this section contained shall be construed to deprive a court of bankruptcy of any power it would possess were certain specific powers not herein enumerated.'

Section 75(a) prescribes that mandatory duties of the trustee are as follows:

'Trustees shall (1) collect and reduce to money the property of the estates for which they are trustees, under the direction of the court, and close up the estates as expeditiously as is compatible with the best interests of the parties in interest.'

As hereinafter pointed out, the Supreme Court of California in Donnelly v. Southern Pacific Co., 18 Cal. (2d) 863, recognizes this rule in an opinion involving a judgment for damages for personal injuries sustained by a person in a railroad collision, while traveling on a free pass, regulated by Interstate Commerce Acts, and after discussing the various

federal and state decisions involving the right to recover from a common carrier while riding on a free pass, the Supreme Court, in reversing the judgment of the Superior Court, said:

'This negligence may have been gross under the California rule, but the Federal cases are clear that such dereliction constitutes negligence and not wanton and reckless misconduct.'

In this connection the rules laid down by the Supreme Court of California in Bigsby vs. Johnston, 18 Cal. (2d) 860, and Union League Club vs. Johnson, 18 Cal. (2d) 275, are entirely beside the point. Neither Bigsby nor the Union League Club were trustees in bankruptcy, nor were they sales upon which the State imposed a tax, judicial sales conducted under a United States Statute in a United States Court; neither was any mandatory duty imposed upon them to make these sales. If they desired, they had a right to retain the property. A trustee in bankruptcy has no such right, as the statute under which his office is created requires him to collect and reduce to money the property for which he is trustee, under the direction of the court, and to close up the estates as expeditiously as is compatible with the best interests of the parties in interest. (Bankruptcy Act, Sec. 47a, 11 U. S. C. A. Sec. 75a.)

ANY PROVISION IN THE RETAIL SALES ACT OF CALIFORNIA OR THE RULES AND REGULATIONS OF THE STATE BOARD OF EQUALIZATION UNDER WHICH IT IS CONTENDED ADDITIONAL BURDENS OR DUTIES MAY BE IMPOSED UPON A TRUSTEE IN BANKRUPTCY, IS IN CONFLICT WITH ITS APPLICABILITY TO FEDERAL LAW, AND IS UNCONSTITUTIONAL.

It has long been settled that where Congress exercises its exclusive jurisdiction, as in the domain of interstate commerce, bankruptcy, naturalization, and

other exclusive legislative fields delegated to it, all state laws on those subjects are superseded; as, for instance, upon the enactment of the Bankruptcy Act of 1898, after a long period during which this country had no Bankruptcy Act, all State Insolvency Laws were suspended and superseded and their courts deprived of jurisdiction over the subject. Holmes vs. Rowe, 97 F. (2d) 537 (C. C. A. 9th Cir.); *In re* Brinn, 262 F. 527.

In Keystone Driller Co. vs. Superior Court, 138 Cal. 738, the court said:

'Our State Insolvency Law is suspended by the National Bankruptcy Law of 1898.'

In Continental Building & Loan Association vs. Superior Court, 163 Cal. 579, the Supreme Court said:

'If these positions are well taken the conclusions for which petitioner contends is irresistible, for it is conceded that petitioner is a corporation conducting a business which brings it within the scope and purview of the National Bankruptcy Act, and it is unquestioned that when the general government has spoken upon the subject of bankruptcy, the operation of all state laws upon the same subject matter is suspended. The ultimate question then, is whether under these concessions and admissions there is still left in the state law any valid provisions entirely without the scope of the National Bankruptcy Act, which provisions may be enforced by the State Courts, or whether, as petitioner contends, the state law is as a whole, and without severable or separable parts a single bankruptcy or insolvency act.'

In the latter case the Supreme Court of California held that a punitive law requiring liquidation of building and loan associations under certain condi-

tions not constituting an act of bankruptcy, did not conflict with the Bankruptcy Act, but nevertheless, recognized the principle that when Congress has legislated on the subject, the State law is powerless.

In the recent case of Donnelly vs. Southern Pacific Co., 18 Cal. (2d) 863, involving a California Statute and its operation on passengers traveling in interstate commerce, the Supreme Court says:

'If a statute is enacted by Congress covering the subject of the state's regulation, it supersedes the state statute or decision. Southern Ry. Co. vs. Railroad Commission of Indiana, 236 U. S. 439; Southern Express Co. vs. Byers, 240 U. S. 612; Adams Express Co. vs. Croninger, 226 U. S. 491; Western Union Tel. Co. vs. Speight, 254 U. S. 17; Western Union Tel. Co. vs. Commercial Milling Co., 218 U. S. 406. If, however, Congress enacts a statute that embraces the general field but does not cover the matter on which the state has ruled, the state statute or decision is superseded only if Congress intended by such legislation to occupy the entire field, thereby excluding all state control. Atchison T. &. S. F. Ry. Co. vs. Railroad Commission, 283 U. S. 380; Kelly vs. Washington, 302 U. S. 1; H. P. Welch Co. vs. New Hampshire, 306 U. S. 79; Kansas City So. Ry. Co. vs. Van Zant, 260 U. S. 549; Southern Express Co. vs. Byers, *supra,* and numerous other citations. The state courts are then bound by federal decisional law in the field. Kansas City So. Ry. Co. vs. Van Zant, *supra;* Southern Express Co. vs. Byers, *supra;* Adams Express Co. vs. Croninger, *supra*; Western Union Tel. Co. vs. Speight, *supra.*'

We think it is clear that Congress intended to legislate fully with regard to the qualifications and duties of trustees in bankruptcy. It has not seen fit

to require them to take out sales tax license from the States permitting them to perform their mandatory duties. The fact that Congress in 1934 enacted Section 124a of Title 28 of U. S. C. A., requiring 'any receiver. liquidator referee, trustee, or other officers or agents appointed by any United States Court *who is authorized by said court to conduct any business and who does conduct any business* shall, from and after June 18, 1934, be subject to all State and local taxes applicable to such business the same as if said business were conducted by an individual or corporation,' does not mean a thing in this case. In the first place, it does not purport to be an amendment to the Bankruptcy Act, which expressly prescribes the duties of the trustee. In the second place the trustee here is not operating the business, but is liquidating it in accordance with the plain mandate of the law. Trustees in bankruptcy stand in a much more advantageous position than do receivers in equity, assignees for the benefit of creditors, and other types of liquidators. The Federal Courts make a distinction between the disabilities of equity receivers and of receiverships so operated and the privileges accorded to a trustee or receiver in bankruptcy. For example, in Southern Bell Telephone Co. vs. Caldwell, 67 F. (2d) 802, in discussing the question of priorities in bankruptcy as distinguished from equity receiverships, the Circuit Court of Appeals for the Eighth Circuit said:

'It is conceded that there is no decision in bankruptcy affording any support to the appellant's claim of priority. The equity foreclosure cases like Miltenberger vs. Logansport C. &. S. W. R. Co., 106 U. S. 286 (and a number of other cases cited) —are without application, and we have no occasion to review them.'

Furthermore, the very fact of the passing of the statute referred to (Section 124a, Title 28 U. S. C. A.) indicates clearly that Congress felt that prior to June 18, 1934 trustees in bankruptcy *operating a business* under the provisions of Subdv. (5) of Section 2 of the Bankruptcy Act were exempt from all taxes imposed by States and local municipalities during the period of their operation, and by the enactment of this statute permitted States and local political bodies to levy taxes on the actual operation of such business.

A great deal of the difficulties which trustees have been encountering with the State Board of Equalization in the last several months are occasioned by a misinterpretation of the case of Boteler vs. Ingals, 308 U. S. 57. In that case, Boteler, as trustee in bankruptcy, was operating a large dairy. He had a number of milk trucks making daily deliveries throughout Los Angeles County and operating on the public highways. On January 1st he did not have sufficient funds in his possession to purchase new license, and the same condition existed after the deadline for obtaining new licenses without penalty on February 5th had passed. Shortly after February 5th he obtained sufficient money to purchase licenses and applied to the Motor Vehicle Department for new licenses for his trucks, tendering it the normal fee. The Motor Vehicle Department refused to issue the licenses without payment of the penalty and Boteler sought *mandamus* from the Referee. The Referee entered an order requiring the issuance of the licenses, which order was affirmed by the District Court, both lower courts holding that the trustee was not subject to such penalty. This court reversed the order, and the Supreme Court granted certiorari. In the opinion in that case Mr. Justice Black was

careful to point out that the trustee was *operating the business* and that the penalty constituted a license fee for the privilege of using the highways of the State of California, and that if the trustee saw fit to use the highways in the conduct of the business he was required to comply with the reasonable police regulations of the State.

HAS THE TRUSTEE A PLAIN, SPEEDY AND ADEQUATE REMEDY AT LAW SUCH AS WOULD BAR HIM FROM INJUNCTIVE RELIEF HERE?

We believe that the contention in the lower court that the trustee is not entitled to injunctive relief is wholly and completely without merit. Here we have the situation of a State Board seeking to interfere with a trustee, an officer of the United States Court, in the conduct of his mandatory duties, and demanding that he take out a license under penalty. (See Sales Tax Act, Sec. 15.)

To say that such court has not the power to protect its officers in the control and disposal of property in its possession and in the performance of their mandatory duties would, we believe, on its face, seem ridiculous. (See Dayton vs. Standard, 241 U. S. 588.) However, Federal Courts have jurisdiction also to enjoin enforcement of an unconstitutional State statute by State officers clothed with authority to enforce it where it violates Federal Constitution. See: Tyson & Bro. United Theatre Ticket Officers vs. Banton, 273 U. S. 418; Pennsylvania vs. West Virginia, 262 U. S. 553; Fox Film Corp. vs. Trumbull, 7 F. (2d) 715; McNaughton vs. Johnson, 242 U. S. 344; Claybrook vs. City of Owensboro, 16 F. 297; Wells Fargo & Co. vs. Taylor, 254 U. S. 175; Caldwell vs. Sioux Falls Stockyard Co., 242 U. S. 559.

The right to enjoin a state officer from enforcing a state statute claimed to violate the Federal Constitution is not affected by whether the enforcement is to be by civil or criminal proceedings. See: Van Deman & Lewis Co. vs. Rast, 214 F. 827; Yee Gee vs. City & County of San Francisco, 235 F. 757; Pierce vs. Society of the Sisters, 268 U. S. 510.

It has been held that the institution of separate actions to recover fees paid under an alleged unconstitutional statute is not adequate remedy at law, as was contended by the Attorney General. See: Wofford Oil Co. vs. Smith, 263 F. 396.

It has also been held that a Federal Court has jurisdiction to enjoin the enforcement of a state statute which is unconstitutional and void, and under which the authorities threaten to seize complainant's property and destroy his business unless he pays a license thereby imposed. See: Minneapolis Brewing Co. vs. McGillivray, 104 F. 258.

In the case at bar, under the State's theory the trustee in bankruptcy, an officer of the United States District Court, should pay this illegal tax and license fee out of funds in *custodia legis* in a Federal Court, to a State Board, and then, notwithstanding the fact that he is an officer of the United States District Court, go into the State courts and maintain expensive litigation to recover it back. Such requirement would be absolutely unreasonable. The State Board of Equalization is demanding that the Bankruptcy Court and its officers pay over to it certain sums of money, disbursement thereof being required to be made by check or draft on designated depositories of bankruptcy funds.

THE CONTENTION THAT THE REFEREE ACTED BEYOND HIS JURISDICTION IS WHOLLY WITHOUT MERIT, AS THE REFEREE IS NOT SEEKING TO RESTRAIN A COURT.

It was contended by the Attorney General in the District Court that a Referee in Bankruptcy has no power to enjoin a State officer in the enforcement of a State Statute. With that we disagree.

Section 38 of the Bankruptcy Act, 11 U. S. C. A., Sec. 66 vests the Referee, subject to a review by the Judge, with jurisdiction to, '(6) Perform such of the duties as are by this Act conferred upon Courts of Bankruptcy, including those incidental to ancillary jurisdiction, and as shall be prescribed by rules or orders of the Courts of Bankruptcy of their respective districts, except as herein otherwise provided.'

Section 2, Subdv. (15), 11 U. S. C. A., Sec. 11, Subdv. (15) vests Courts of Bankruptcy with jurisdiction to, 'Make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this Act. Provided, however, *that an injunction to restrain a court may be issued by the Judge only.*'

That an injunction will lie against a State Board or Commission to prevent a violation of the rights of a party under the Federal Constitution, has been held in Union Light, Heat & Power Co. vs. Railroad Commission of Kentucky, 17 F. (2d) 143; also, Evansville Brewing Ass'n. vs. Excise Commission of Jefferson County Alabama, 225 F. 204.

The only jurisdiction now expressly withheld from Referees under a general Order of Reference is the power of commitment for contempt. (Bankruptcy

Act, Sec. 38, Subdv. 2.) Under the act of 1938 a general Order of Reference is sufficient to vest them with jurisdiction to adjudicate bankrupts or dismiss petitions, to grant or revoke discharges, and perform many other judicial acts which under preceding bankruptcy laws they were only permitted to certify to the District Judge for determination.

We respectfully submit that the Referee did not act beyond his jurisdiction."

Answer and Reply to Appellant's Brief.

We believe the issue in this case may be reduced to a single determination. In fact the Appellant states: (App. Br. p. 10):

> "Briefly summarized, however, appellant submits that the record herein establishes clearly that the five trucks sold on March 29, 1946, were sold by appellee during a period in which he was operating the business of the bankrupt. *It is not disputed that the five sales of trucks were liquidating sales.*"

And at page 20:

> "The only question remaining for consideration, therefore, is whether gross receipts derived by appellee from the sale of capital assets, namely, five trucks held by him in the course of his retail sales activity, are includible in the measure of the tax imposed upon appellee as a retailer under the California Sales and Use Tax Law."

It Is Immaterial Whether "Liquidation" Sales of Trucks Were Before, During, or After Trustee's Operation.

It hardly appears necessary to straighten out such hiatus as is suggested by counsel for appellant between the stipulation of Goggin, trustee, and the findings upon the question of whether the "operation of the business" covered a period to March 22, March 29 or May 1, 1946.

In any event the Brief of the Appellant states (and we agree) that,

(1) (page 10) "It is not disputed that the five sales of trucks were *'liquidation sales.'*"

(2) (page 8) That all of the retail sales effected by Goggin, both as receiver and trustee in the "*operation of the business*" were reported by him and the sales tax paid by him thereon (other than the tax on the said liquidation sales of the five trucks).

The District Judge in his Opinion in what he believes is an all inclusive summary of the entire subject of the applicability of State Sales Taxes to bankruptcy administration (and from which we have hereinabove extensively quoted) discussed many collateral points of general interest on the subject.

The Problem Simply Stated.

However, it occurs to us that the only question before the Court here is: "*Should the trustee be required to pay a sales tax upon his bankruptcy liquidation sales of the five trucks?*" The question presented to this Honorable Court in *State Board of Equalization v. Boteler (In re Davis Standard Bread Co.)*, 131 F. 2d 386, Nov. 10, 1942, bears great similarity. Therein the kindred question

was "should the trustee in bankruptcy pay a California sales tax upon sales of '*furniture, fixtures, equipment and other miscellaneous items of the business.*'" (From the opinion, page 387.)

> "It cannot be doubted that if the authorities can be read so as to support the proposition that the trustee in making the sales in question is 'carrying on the business' the tax attempted to be imposed would be proper. We think they cannot be so read."

and page 388:

> "His (Boteler, the trustee) activities did not render him taxable under the terms of the California Retail Sales Act. . . ."

To delineate the problem further we can point out that as conceded by the State Taxing Agency, the sale of the five trucks was a *liquidation sale*. Certainly it was no part of the "operation of the business."

It makes little difference whether it was made before or after or during the period of the operation of the business. The bankrupt was engaged in manufacturing wooden cabinets and like fixtures and not in the operation of a used truck business. Therefore we conclude that the problem should be considered solely upon the basis of whether or not sales tax on liquidation sales should be paid by a trustee in bankruptcy.

The Fundamental Question Has Already Been Answered by This Court.

It was our view that the Court's decision (*State Board of Equalization of State of California v. Boteler*) *definitely* settled that question.

Reliance Upon Court's Prior Decision.

At least following that decision the trustees in bankruptcy in the many bankruptcy proceedings pending before the United States District Courts within the State of California have not paid any sales tax on their liquidation sales. In fact the bankruptcy courts (both the Referees and the United States District Judges) have made numerous orders prohibiting them from paying the same.

Many thousands of bankruptcy estates during the interim have been administered, distributed and closed without the payment of the said sales tax.

Answer to Appellant's Specifications of Error.

The Appellant contends under "D—Specification of Errors", page 11, that the District Judge "failed to give effect to the provisions of Section 960, 28 U. S. C. A., which provides that any officer or agent conducting any business . . . shall be subject to all state taxes applicable to such business." And we submit that the said segregation of the District Judge was correct.

It Is Possible That Trustee Who Acts as Employer and Hires Assistants May Be Required to Pay Tax Because Thereof.

The Appellant cites the case of the 8th Circuit decided in 1943, *State of Missouri v. Gleick,* 135 F. 2d 134, in support of its contention that trustees in bankruptcy in liquidating estates in bankruptcy were "operating" or "conducting" the business of the bankrupt. However, the said case merely determines that where the trustee in Missouri employs persons to work for him that he is an employer and liable to the Missouri Unemployment Law for contributions. To the same effect is the case of *In*

re Mid American Co., 31 Fed. Supp. 601, charging the trustee in bankruptcy with the tax upon his employees in Illinois.

We believe the result reached in the two cases is predicated on the facts that the trustee in bankruptcy when he employed individuals was actually an *"employer"* under the said state section. We believe the same decisions could have been arrived at without any reference to the provisions to Section 960, 28 U. S. C. A. The Judge in the latter case said, "There is no judicial warrant for construing Section 124a (Sec. 960, 28 U. S. C. A.) in such manner as to deprive employees of the trustee of the benefits of coverage under the Illinois Unemployment Compensation Act. . . . merely because their services were performed for a trustee in bankruptcy . . . defined as an 'employment unit' in the Illinois Unemployment Compensation Act."

In other words there could be no tax upon the trustee's activity, upon his official duties, *but* when he goes beyond that and becomes an employer the said courts held he should pay the tax as an employer.

What Was Intended by Congress Through Adoption of Section 124a, Title 28 U. S. C. A.?

The legislative background of Section 124a, Title 28 U. S. C. A. shows that in certain large operating bankruptcies the receivers and trustees were carrying on oil businesses and not paying any of the tax as was required by competing businesses. The argument before Congress was to remove this restriction and to compel the receiver and/or trustee who so operated a business to pay the tax. This argument was perfectly logical and effective from and after June 18, 1934. The receiver or trustee

who was authorized by the Court to *conduct any business* or who does conduct any business, is subject to the tax applicable to said business the same as if such business were conducted by an individual or corporation.

We pause here and point out that the trustee is not *authorized* by the bankruptcy court to conduct his *statutory duties of liquidation as required by the Bankruptcy Act.* The duty to liquidate is inherent to the office. So it is quite obvious that the reference to "conduct of the business" as referred to in the said Act is not to the bankruptcy statutory liquidation process but the reference is to a carrying on "as if the business were conducted by the bankrupt."

And, that is not only the general view of the 9th Circuit, but also the definition given in *State Board of Equalization v. Boteler.*

Many of Appellant's Objections and Complaints Have Already Been Answered.

The Appellant under its argument under "E," "F," "G", "H", "I", pages 11 to 13, raises questions and criticisms objecting to the manner in which it was called into the Bankruptcy Court, the "suit" against it, the fact that it was not a "party" to the bankruptcy proceedings, the injunction against it and the overall jurisdiction (or lack thereof) of the Bankruptcy Court.

These same general points and contentions were raised in the prior case of this court referred to hereinabove. They were likewise raised before Judge Paul J. McCormick in the *California Pea Products* case. And, we do not see in Appellants present arguments any reason to assume that this Honorable Court will be influenced thereby.

We do again state we do not believe there is any substance whatsoever to Appellant's argument that the tax should be charged because the liquidation sales of the trucks were made at a time (if such was the case) while the trustee was, on the other hand, operating the business. The said contention of Appellant being that the said liquidation sales should be included and aggregated with the "operation of business" sales and the tax paid thereon.

We believe that the law has already been established that there is no sales tax on trustee liquidation sales regardless of the time made in the bankruptcy administration.

We are much more vitally concerned with the Appellant's contentions under "D", page 26:

> "Trustees in Bankruptcy are subject to the California Sales and Use Tax Law even though they engage solely in liquidation activities if they make a sufficient number of retail sales."

"E", page 29:

> "Trustees in Bankruptcy making liquidation sales only are retailers within the purview of the California Sales and Use Tax Law if the sales are sufficient in scope and number."

"F", page 30:

> "There is no Federal Constitutional or Statutory prohibition against the imposition of a non-discriminatory state tax upon trustees in bankruptcy."

These contentions could only be supported on one or the other of the following:

1. That the trustee in making his sales is a "retailer" under the State Statute. That the State Statute was amended to include a "trustee" and that this referred to and included "trustee" in bankruptcy.

2. That there is no Federal Statutory Prohibition against levying the said tax.

3. That although it is conceded that the sales tax is upon the trustee as the seller that no burden is cast upon the trustee.

These very points were considered by the Court in *State Board of Equalization v. Botcler* with the exception of the question of the subsequent amendment which added "trustee."

However, it follows from the said decision that such amendment could not in any manner effect the result thereof. The Court considered the then Section 124a, Title 28 U. S. C. A. as the conferring by the Federal authority of the right to the State to tax the bankruptcy administration when the business of the bankrupt was conducted. The Court said, *State Board of Equalization v. Boteler*, p. 387:

> "It cannot be doubted that if the authorities can be read so as to support the proposition that the trustee in making the sales in question is 'carrying on a business', the tax attempted to be imposed would be proper. We think they cannot be so read."

Interference With Bankruptcy Administration.

The California sales tax is payable by and charged to the seller who must take out the permit, make the reports, etc. In the case, *City of New York v. Jersawit*, 85 F. 2d 25 (2nd Cir.), the Court in referring to the collection by a trustee of a consumer tax of the City of New York upon sales said:

> "A tax on a sale made by a trustee under an order of court for purposes of liquidation if payable directly and primarily by him would doubtless be a burden on a governmental instrumentality, for a judicial sale in liquidation of a bankrupt estate would in a peculiar sense involve the exercise of a federal function. Indeed, without the exercise of such a function and the power thus to dispose of assets, administration in bankruptcy would hardly be practicable. A tax on the vendee in connection with a sale in liquidation of a bankrupt's estate is, at least in a formal sense, quite different from a tax for which the vendor is made primarily liable."

Thus we see the inapplicability of that case to the provisions of the California Sales Tax. Appellant argues that we should consider this case as persuasive here.

Is There Interference Imposed Upon the Trustee by the Terms of the Sales and Use Tax Law of California?

This is what the liquidating trustee is confronted with:

(a) Section 6051 of Chapter 2, Revenue and Taxation Code of California provides, "for the *privilege* of selling tangible personal property at retail a tax is hereby imposed. . . ."

(b) Section 6066: "Every person . . . shall file with the board an application for permit for each place of business. . . ."

(c) Section 6067: "at the time of making an application the applicant shall pay to the board a permit fee. . . ."

(d) Section 6070, Revocation of Permit: "The board shall not issue a new permit after the revocation of a permit unless it is satisfied that the former holder will comply, etc."

(e) Section 6203: "Every retailer . . . shall . . . collect the tax from the purchaser."

(f) Section 6207: "Every person violating Sections 6203 (collection from purchaser) and 6205 (advertising that tax will be assumed or not added to selling price) 6206 (displaying tax separate from list price) shall be *guilty of a misdemeanor.*"

(g) Section 6226: "Every retailer . . . shall register with the board and give name and address of all agents operating in this state . . . and such other information as the board may require."

(h) Section 6452: ". . . A return . . . shall be filed with the board."

(i) Section 6511: "If a person fails to make a return, the board shall make an estimate . . . adding . . . penalty equal to 10 per cent thereof."

(j) Section 6514: "If failure of any person to file a return is due . . . an intent to evade this part or rules and regulations a penalty of 25 percent."

(k) Section 6701: "Security. The board, whenever it deems it necessary to insure compliance . . . may

require any person subject thereto, to deposit with it such security as the board may determine, The board may sell the security at public auction . . ."

(1) Section 6796: ". . . the board may forthwith collect . . . the board shall seize any property . . . and sell . . . at public auction."

We submit that these processions do place a huge burden on the trustee. He must obtain a permit to perform his duties. He must pay for the permit. He is put to a very considerable expense by the state law. His activities are interfered with. It is quite obvious that the enforcement Sections were never intended to apply to trustees in bankruptcy.

The Appellant does not appear to be concerned with anything except the affixing of the tax liability upon the trustee and its attitude is that if it can do so then regardless of its many regulations it will only apply those against the trustee which do not interfere with his Court duties.

And, we submit that the imposition of the sales tax is not only a "burden on the governmental instrumentality" (as referred to in the above *City of New York v. Jersawit* case), but it also is a harmful interference with the bankruptcy administration not sanctioned by Congress.

If this sales tax is payable as contended on liquidation sales by trustees in bankruptcy then it is quite apparent that all such trustees in bankruptcy in California have been and now are committing crimes under this State Statute.

Conclusion.

We respectfully submit that the Orders of the Referee and the District Judge should be affirmed.

Respectfully submitted,

FRANK C. WELLER,
HUBERT F. LAUGHARN,
THOMAS S. TOBIN,
Amici Curiae,

No. 12727

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CALIFORNIA STATE BOARD OF EQUALIZATION,

Appellant,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of West Coast Cabinet Works, Inc.,

Appellee.

APPELLANT'S REPLY BRIEF.

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APPELLANT'S REPLY BRIEF.

Preliminary Statement.

The briefs filed by appellee and *amici curiae* are for the most part concerned with matters discussed by the District Judge in his opinion and analyzed in Appellant's Opening Brief.

Both appellee and *amici curiae* fail to recognize that the broad question presented in this appeal is whether this Court should hold that trustees in bankruptcy in their fiduciary capacities are subject to the non-discriminatory tax imposed by the California Sales and Use Tax Law in connection with sales of tangible personal property amounting to millions of dollars in value over the years, the sales being made for the benefit of creditors of bankrupts and the trustees in bankruptcy being authorized under the State taxing statute to pass on *in full* to their vendees the amount of tax payable under the statute.

Although it is apparent that exempting trustees in bankruptcy from the application of the California Sales and Use Tax Law places them in a preferential position in so far as all other sellers of tangible personal property in this State are concerned, neither appellee nor *amici curiae* have demonstrated any constitutional ground upon which exemption must be predicated nor have they directed this Court's attention to matters which from a policy point of view would indicate the desirability of exempting trustees in bankruptcy from the application of the California Sales and Use Tax Law. To the contrary, both appellee and *amici curiae* have ignored the portions of Appellant's Opening Brief which go to the heart of the broad issue involved and are apparently content to indulge in generalizations predicated upon erroneous premises.

Analysis of Appellee's Brief.

Although it is submitted that appellee's brief has ignored the basic issues presented and failed to demonstrate even remotely that the broad question presented should be answered in the negative, the Court's attention is directed to the following portions of appellee's brief lest silence on the part of appellant be misinterpreted:

1. Appellee's Preliminary Statement is entirely misleading in that it ignores the testimony of appellee [Tr. 98] to the effect that he completed two sales of cabinets on April 23 and May 14, 1946, respectively. Also ignored is the audit of appellee's activities during the period March 12, 1946, to May 14, 1946, inclusive [Tr. 64-66], which discloses that various sales of tangible personal property at retail were made by appellee during that period. (See also, App. Op. Br. 3-7.)

2. In discussing appellee's activities, after adjudication, appellee cites at page 3 of his brief, pages 95 and 96 of the transcript. No reference is made to page 98 of the transcript, *supra*.

3. Commencing at page 7 of appellee's brief it is contended that appellant's counsel have erroneously set forth the purport and effect of the District Court's decision, and this portion of appellee's brief is preceded by appellee's version of the decision below. The decision of the District Judge is, of course, available to this Court and it will obviously serve no purpose for counsel to belabor their respective interpretations of that decision. It is, however, respectfully submitted that when the portions of the decision below referred to by appellee in his brief are examined in light of the surrounding context, it will be apparent that Appellant's Opening Brief does not erroneously set forth the purport and effect of the District Court's decision.

For example, appellee fails to recognize that if trustees in bankruptcy are not "persons" within the meaning of the California Sales and Use Tax Law that Law would not apply to them regardless of the nature of their activities. (Appellee's Br. 9.) And this would be true even if trustees in bankruptcy could be taxed without specific congressional consent. We are unable to perceive how it can be conceded that trustees in bankruptcy are "persons" within the meaning of the California Sales and Use Tax Law when they conduct the business of a bankrupt and yet argued that trustees in bankruptcy are not "persons" when they are not so engaged. It is submitted that appellee fails to recognize that whether or not trustees in bankruptcy are included within the definition of "persons"

as that term is used in the California Sales and Use Tax Law, is a matter involving only the construction of the State taxing statute and not any other.

4. Under the heading "The Findings Are Supported by the Record" (Appellee's Br. 10) appellee alleges that "It must be presumed as a matter of law" that appellant would enforce the provisions of the California Sales and Use Tax Law. Appellee fails to note, however, that it must likewise be presumed as a matter of law that appellant would proceed only in a lawful manner. And that is precisely why appellant has pointed out in its opening brief that there is nothing in the record to support the issuance of an injunction against appellant.

In so far as the District Judge's Finding VIII is concerned (Appellee's Br. 11), see appellant's Objections to Proposed Findings Prepared by Appellee [Tr. 37, last paragraph].

Although appellee asserts that the record herein does not disclose that the Board would not seek to compel payment of the tax involved by appellee or from the instant bankrupt estate he again fails to note that there is nothing in the record to support his contention that appellant would have proceeded in an improper or unlawful manner.

5. Appellee's discussion of the jurisdictional aspect of this case ignores the fact that the District Judge himself raised and considered the jurisdictional question.

6. In arguing that the proceedings below did not amount to a suit against the State of California without its consent (Appellee's Br. 12, *et seq.*), appellee

makes the erroneous contention that "Appellant came into the Bankruptcy Court to license the Trustee and receive funds from the bankrupt estate." This, of course, is not so. To the contrary, we believe this Court can take judicial notice of the fact that appellee like, indeed, all retailers in this State, applied to appellant for a permit under the California Sales and Use Tax Law and that appellee filed tax returns with appellant and paid taxes due under the California Sales and Use Tax Law to appellant. [See also Tr. 88].

Appellee cites no authority for the broad statement at the commencement of page 13 of his brief that all persons dealing with officers of the court in bankruptcy proceedings during the administration of bankrupt estates are subject to the summary jurisdiction of the Bankruptcy Court. The fallaciousness of this contention need not be demonstrated.

7. Commencing at page 13 of appellee's brief, appellee contends that the instant case falls within one of the exceptions to the well established general principle that a State may not be sued without its consent either directly or through one of its duly constituted agencies. The exceptions referred to by appellee all involve acts of State officials or agencies which are not legally authorized or which exceed or abuse the authority or discretion conferred upon such officials or agencies by State law. The record in the instant case fails to disclose any unlawful or wrongful action on the part of appellant.

8. Appellant does not contend that a Federal Court's jurisdiction may be defeated by the enactment of a State statute (see App. Op. Br. 14). The ques-

tion actually presented is whether jurisdiction to issue an injunction against the State taxing agency exists in the absence of any improper or wrongful action on the part of the State agency.

9. Although it is true that the tax liabilities incurred by a trustee in bankruptcy during his administration of a bankrupt estate constitute administrative expenses (Appellee's Br. 15) this fact does not in and of itself give the Bankruptcy Court summary jurisdiction over those to whom such administrative expenses would be payable if proper.

Section 62(a) of the Bankruptcy Act provides that doubtful items of administrative expense are to be reported to the referee having jurisdiction and that the referee shall then order the trustee to pay or not to pay the doubtful items as the case may be. It is clear (2 Remington on Bankruptcy 150, *et seq.*) that those who seek payment of doubtful items of administrative expense may not file claims for those items with the Bankruptcy Court. And, it is additionally clear that, if a trustee in bankruptcy has been ordered not to pay a doubtful item, any person thereafter seeking payment may thereupon sue the trustee with or without the permission of the Bankruptcy Court as the case may be. In this connection, see *In re Kalm & Berger Mfg. Co.,* 165 Fed. 895, and *In re Roberts,* 169 Fed. 1022.

10. Commencing at page 16 of appellee's brief, it is contended that appellant acquiesced in the Bankruptcy Court's jurisdiction. This contention, however, overlooks the well established principle that parties cannot, even by mutual consent, confer upon a court

jurisdiction over a subject matter outside the jurisdiction conferred by the provisions establishing the court.

It is too well established to warrant citation that Federal District Courts are courts of limited jurisdiction.

11. In contending that the California Sales and Use Tax Law does not afford a trustee in bankruptcy a plain, speedy and efficient remedy (Appellee's Br. 18, *et seq.*) appellee ignores the fact that if he had properly reported the instant tax liability to the referee pursuant to Section 62(a) of the Bankruptcy Act, and the referee had ordered the appellee not to pay the item, the within estate could have been lawfully distributed without regard to the tax item and without the possibility that the trustee might be subject to surcharge, if appellant had not commenced a timely action against appellee to compel payment. Furthermore, appellee ignores entirely the provisions of the California statute which authorize him to collect the full amount of the tax from his vendees. If appellee had acted with due regard to the State's interest in this matter, he would have collected the taxes in question and held them subject to a determination of the issues raised in this appeal. Regardless of the outcome of this appeal, assets of the estate would not have been involved.

The contention that appellee did not have a plain, speedy and efficient remedy under State law can only be made with a complete disregard for the provisions of State law.

12. In referring to Part II of Appellant's Opening Brief (see appellee's brief commencing at page

21) appellee seeks to persuade this Court that appellant's analysis of the opinion below is fallacious in many respects.

For example, the appellee quotes a portion of the first paragraph on page 37 of Appellant's Opening Brief and refers to it as a "statement . . . that the opinion [below] concludes 'that the California Sales Tax cannot constitutionally be imposed upon trustees in bankruptcy in connection with liquidation sales made by them.'" Reference to page 37 of Appellant's Opening Brief will disclose appellant's statement that "Commencing at page 654 of the reported Opinion below, the learned District Judge cited various cases . . . to support his conclusion, which was quite apparent at this point in his Opinion, that the California Sales Tax cannot constitutionally be imposed upon trustees in bankruptcy in connection with liquidation sales made by them."

Appellee also takes exception to the statement on page 47 of Appellant's Opening Brief that the District Judge erroneously assumed that compliance with the California Sales and Use Tax Law by appellee would have resulted in interference with the Bankruptcy Court's control of appellee's activities and the property in its custody. Ignored entirely are pages 37 to 41 of Appellant's Opening Brief.

13. The closing portion of appellee's brief ignores the basic question presented on this appeal and the practical operation of the State taxing statute in relation to the field of bankruptcy. (See App. Op. Br. 30-36.)

Analysis of Amici Curiae Brief.

The brief filed by *amici curiae* is unfortunately replete with generalities, references to factual situations other than the one disclosed by the record herein, and repeated reiterations that the imposition of the California Sales Tax upon trustees in bankruptcy would amount to an interference with the Bankruptcy Court's exclusive jurisdiction over bankruptcy estates. Furthermore, the brief of *amici curiae* ignores the basic question presented, as set forth in the opening paragraphs of this brief and the latest decisions of the United States Supreme Court upholding non-discriminatory State taxes.

1. Whereas, appellee indicates at page 9 of his brief that the Judge below did not attribute any "sanctity" to the trustee herein because of his status as an officer of the Bankruptcy Court, and whereas appellee seeks to persuade this Court that the Judge below concluded that the California Legislature could include trustees in bankruptcy (such as appellee) within the scope of the California Sales and Use Tax Law if it chose to do so, *amici curiae,* to the contrary, take the position that trustees in bankruptcy are immune from state taxation in making liquidation sales because they act as officers of the judicial arm of the Federal Government.

2. It is stated at page 8 of the *amici curiae* brief that counsel for appellant contended in the District Court that the sales made by an individual who acts as a trustee in bankruptcy in numerous bankrupt estates should be aggregated in considering the tax liability of a trustee in bankruptcy in his fiduciary capacity in so far as a single estate is concerned. We

do not recall making that contention, and do not advance it here. However, inasmuch as *amici curiae* have raised the point, if it is true (as indeed it is) that a single individual makes numerous sales of tangible personal property as trustee in bankruptcy of numerous bankrupt estates, that is all the more reason for denying him a preferential position in so far as all other sellers of tangible personal property in this State are concerned with regard to the application of a nondiscriminatory tax which may be passed on in full to the purchasers of said tangible personal property.

3. In contending that there is no basis for the "bridging over" argument of appellant, *amici curiae* fail to recognize that the "bridging over" factual aspect of the case is pertinent to a consideration of whether the California Sales and Use Tax Law is applicable to liquidation sales made by a trustee in bankruptcy who has conducted the business of a bankrupt. (See App. Op. Br. 20.)

4. *Amici curiae* do not answer but ignore pages 37 to 41 of Appellant's Opening Brief and infer at page 13 of their brief that none of the enforcement provisions of the California Sales and Use Tax Law may properly be invoked with respect to trustees in bankruptcy.

5. We trust the Court will not be misled by the attempt to persuade it that merely because all of the enforcement provisions of the California Sales and Use Tax Law are admittedly not applicable to trustees in bankruptcy, a judicial determination of that fact would result in an emasculation of the State taxing statute which would "deny the State the traditional

and almost universal method of enforcing prompt payment." (*Amici Curiae* Br. 13.)

6. Likewise, we trust this Court will not be misled by the subtle inference (*Amici Curiae* Br. 13) that upholding the application of the non-discriminatory State tax to trustees in bankruptcy will "precipitate conflict or occasions for conflict between federal administration of the Bankruptcy Act and state administration of the Sales and Use Tax Law; . . ."

7. Equally misleading is the statement (*Amici Curiae* Br. 13) that the State did not intend, in the absence of Congressional consent, to interfere with or to frustrate the powers conferred upon Congress by the Bankruptcy Clause of the Constitution. We are unable to comprehend the repeated references to interference with the Federal Government's supreme power in the bankruptcy field when the record herein discloses no such interference and when this Court may take judicial notice of the fact that there never has been any interference.

8. *Amici curiae,* like appellee, concede that the California Sales and Use Tax Law applies to trustees in bankruptcy when they are operating and carrying on the business of the bankrupt. We are unable to comprehend, as we have stated above, how the term "persons" in the California Sales and Use Tax Law can be construed as including only certain trustees in bankruptcy and not all of them, regardless of the nature of their activities. (*Amici Curiae* Br. 15.)

9. Commencing at the last paragraph of page 15 of their brief, *amici curiae* refer to the "claim" for an administrative tax liability and "objections" thereto. This is again misleading inasmuch as "claims", as that

term is used in the Bankruptcy Act, are not filed with the Bankruptcy Court in bankrupt estates for administrative items. Nor are we aware of any provision in the Bankruptcy Act for the hearing of objections to "claims" for administrative items.

10. On page 16 of their brief *amici curiae* refer to "The contention that the trustee could be held in his individual capacity" for non-payment of administrative items. This statement is misleading in that it infers the possibility of surcharge even if a trustee in bankruptcy complied with Section 62(a) of the Bankruptcy Act. Additionally, the individual liability of appellee is not involved herein.

11. It is interesting to note that in none of the decisions cited by *amici curiae,* commencing at page 17 of their brief, is there any discussion of the issues raised by appellant herein.

12. The excerpt from the brief filed by *amici curiae* in *State Board of Equalization v. Boteler,* 131 F. 2d 386, is certainly irrelevant, if not misleading, in that it seeks to persuade this Court that the questions here presented are the questions quoted on page 25 of the *amici curiae* brief. It is interesting to note that the first question set forth assumes that the State of California asserts the right to project itself into the administration of bankrupt estates and that the second question assumes an illegal encroachment upon the duties and prerogatives of officers of the District Court. The record herein does not show nor can it be shown with respect to any bankruptcy matter, commencing with the enactment of any taxing statute by the Legislature of the State of California, that the State of California has sought, or is seeking,

the right to project itself into the administration of bankrupt estates or that the State of California seeks to illegally encroach upon the duties and prerogatives of officers of the United States District Court.

The only question before this Court, if we may again state it, is whether or not a non-discriminatory State tax enacted for revenue raising purposes only and not for regulation in any respect whatsoever, may properly be imposed upon trustees in bankruptcy in connection with liquidation sales made by them.

13. Commencing at page 35 of their brief *amici curiae* purport to answer and reply to appellant's brief. It is apparently the view of *amici curiae* that even though a trustee in bankruptcy be operating the business of a bankrupt and, accordingly, concededly subject to the California Sales and Use Tax Law the gross receipts derived from liquidation sales during the course of operation are not to be included in the measure of tax despite the fact that the California Law so provides, as appellant has attempted to point out in its opening brief.

The Court's attention is directed to the distinction to be made between whether the California Sales and Use Tax Law purports to include in the measure of tax the gross receipts derived from liquidating sales, and, if so (the California courts having so held), whether there is any Federal constitutional or statutory prohibition against such inclusion.

14. *Amici curiae* state, at pages 37 and 38 of their brief, that the questions here involved have already been decided not only by this Court but by the District Courts in this State as well. This is, of course, not so, as *amici curiae* themselves have recognized at

page 11 of their brief whereat they state that in June of 1945 the definition of "person" in the California Sales and Use Tax Law was amended by the inclusion of trustees and the United States. This Court has had occasion to consider whether trustees in bankruptcy were "persons" within the meaning of the California Sales and Use Tax Law prior to the aforesaid 1945 amendment. This is the first appeal before this Court involving the effect of the 1945 amendment and whether the California Sales and Use Tax Law, as it now reads, purports to apply to trustees in bankruptcy.

15. *Amici curiae* seek to distinguish *State of Missouri v. Gleick,* C. C. A. 8, 135 F. 2d 134, upon the ground that the Eighth Circuit case involved the application of a state statute to a trustee in bankruptcy by virtue of his status as an employer, whereas the California statute applies to a trustee in bankruptcy as a "retailer." We are unable to perceive a logical or legal basis or policy consideration upon which such a distinction can be predicated, especially so when the California tax, like the Missouri tax, is a non-discriminatory one, and even more especially so when the California tax, unlike the Missouri tax, can be passed on in full to those who purchase assets from a bankrupt estate. It would appear, if distinctions are to be drawn, that the Missouri tax is more vulnerable to attack in that payment of that tax would deplete the assets of a bankrupt estate whereas compliance with the California Sales and Use Tax Law has no

impact whatsoever upon the assets of a bankrupt estate. (*Amici Curiae* Br. 38, 39.)

16. The discussion of congressional intent in enacting former Section 124(a), Title 28, U. S. C., ignores the subsequent decision of the United States Supreme Court in *Graves v. People of State of New York, ex rel. O'Keefe* (1938 Term), 306 U. S. 466, 59 S. Ct. 595, 83 Law Ed. 927, and subsequent pertinent decisions. It is submitted that it cannot be validly argued subsequent to the *Graves* case, that non-discriminatory state taxation of trustees in bankruptcy is dependent upon congressional consent. (*Amici Curiae* Br. 39, 40.)

17. Although *amici curiae* allege on pages 40-42 of their brief that many of appellant's "objections and complaints" have already been answered by this Court, we are unaware of any decision of this Court in which the contentions advanced by appellant herein are discussed.

18. *Amici curiae* close their brief with a final attempt to persuade this Court that upholding the imposition of the California Sales Tax upon trustees in bankruptcy would result in an interference with bankruptcy administration. We direct the Court's attention to a significant omission from the brief filed by *amici curiae,* namely, even an attempt to demonstrate that the alleged interference would result or that interference has been experienced in the past. As we have pointed out above, the record now before the Court fails to disclose any interference whatsoever.

Conclusion.

Inasmuch as appellee and *amici curiae* have failed to demonstrate that there is any bar to the imposition of the non-discriminatory California Sales Tax upon trustees in bankruptcy making liquidation sales of tangible personal property, and inasmuch as such a bar does not exist, under the latest decisions of the United States Supreme Court, it is submitted that the decision below should be reversed.

Respectfully submitted,

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No. 12727

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

California State Board of Equalization,

Appellant,

vs.

George T. Goggin, Trustee in Bankruptcy of the Estate of West Coast Cabinet Works, Inc.,

Appellee.

PETITION FOR REHEARING.

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CALIFORNIA STATE BOARD OF EQUALIZATION,

Appellant,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of WEST COAST CABINET WORKS, INC.,

Appellee.

PETITION FOR REHEARING.

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The undersigned, your petitioner, respectfully submits that it has been aggrieved by the Opinion of Your Honors rendered herein on the 21st day of August, 1951, and by the concurring Opinion herein dated August 27, 1951, in the respects hereinafter set forth, and prays for a rehearing of said matter:

1. Neither of the aforesaid Opinions take into account all the facts fully set forth with appropriate transcript references in Appellant's Opening Brief, pages 3-8, inclusive. No mention is made in either of the aforesaid Opinions of the fact that not only did appellee apply for and obtain a permit under the California Sales and Use Tax Law but that appellee was allowed an additional fee for operating the busi-

ness of the bankrupt as trustee. Additionally, no mention is made of the fact that numerous retail sales and sales for resale were made by appellee prior and subsequent to the sale of the five trucks involved herein.

2. With further reference to factual matters, the majority opinion erroneously concludes, without support in the record herein, that upholding the application of the California Sales and Use Tax Law to liquidation sales made by trustees in bankruptcy would foster conflict between Federal and State laws. As was indicated during lengthy oral argument, this conclusion has no basis in fact.

3. The concurring Opinion of the Honorable Judge Fee proceeds on the premise that upholding the application of the California Sales and Use Tax Law to liquidation sales made by trustees in bankruptcy will "burden or impede administration of acts relating to bankruptcies." It is respectfully submitted that this premise cannot be supported. The application of non-discriminatory state taxes (such as the taxes imposed under the California Sales and Use Tax Law) do not, as a matter of fact, burden or impede the administration of bankrupt estates, as recognized by the numerous cases cited by appellant in the briefs heretofore filed.

4. Both Opinions ignore the true nature of the Order made by the District Judge below. That Order permanently enjoins the Board from enforcing any of the provisions of the Califonia Sales *and Use Tax* Law with reference to the sales made by appellee of the five trucks referred to in the majority Opinion. This point is directed to the Court's attention inas-

much as the California Sales and Use Tax Law, California Revenue & Taxation Code, Division 2, Part 1, effective July 1, 1943, imposes not one tax but *two* taxes. The majority Opinion refers only to the sales tax aspect of the statute and ignores completely the use tax provisions which, in the light of the numerous decisions cited on that point in Appellant's Opening Brief, including the decision of the Second Circuit in *City of New York v. Jersawit,* 85 F. 2d 25, clearly appear to be applicable to liquidation sales made by trustees in bankruptcy.

5. The majority Opinion disposes of appellant's contentions as to lack of jurisdiction without reference to the decision of the United States Supreme Court, decided May 21, 1951, in *Alabama Public Service Commission v. Southern Ry. Co.,* 71 S. Ct. 762, and to the excellent analysis of Federal District Court jurisdiction in the concurring opinion of Mr. Justice Frankfurter. Both the *Lyford* and *Gardner* cases referred to on pages 2 and 3 of the majority Opinion herein deal *not* with tax liabilities incurred during the course of administration but with liabilities existing prior to bankruptcy and set forth by creditors in proofs of claim.

6. Although numerous California cases are cited at page 5 of the majority Opinion to support the proposition that sales made in the process of putting an end to a business are not within the scope of the California statute, it is to be noted that this point was particularly left open in *Los Angeles City High School District v. State Board of Equalization* (1945), 71 Cal. App. 2d 486, 163 P. 2d 485. Furthermore, although the decision of the California Su-

preme Court in *Coca-Cola Co. v. State Board of Equalization* (1945), 25 Cal. 2d 918, 156 P. 2d 1, is cited at page 5 of the majority Opinion, no reference is made to the record herein in so far as it relates to appellant's administrative construction of the statute involved and the portion of the aforesaid decision which provides that such construction "is entitled to great weight, and courts will not depart from such construction unless it is clearly erroneous or unauthorized."

7. In considering the California statute, at least in so far as it pertains to the California Sales Tax, the Court has given no recognition nor effect to the provisions contained in Sections 6006.5 and 6367, which define and exempt certain occasional sales and to the other specific exemption provisions in the statute. This point is directed to the Court's attention in view of the language contained in the decision of the California Supreme Court in *Kamp v. Johnson,* 15 Cal. 2d 187, 191:

> ". . . The broad definition of the term 'retail sale' as 'a sale to a consumer or to any person for any purpose other than for resale in the form of tangible personal property . . .' compels the conclusion that the tax must be paid at some time with respect to all tangible personal property sold for use or consumption and the sale of which is not specifically exempted from the tax . . ."

8. Both the majority and concurring Opinions cite and rely upon *McCulloch v. Maryland,* 17 U. S. 316, disregarding completely the decision of the United States Supreme Court in *Graves v. People of*

the State of New York, ex rel. O'Keefe, 306 U. S. 466, 59 S. Ct. 595, 83 L. Ed. 927, the decision of an Illinois District Court in *In re Mid America Co.,* 31 Fed. Supp. 601, and the decision of the Eighth Circuit in *State of Missouri v. Gleick,* 135 F. 2d 134.

9. Also ignored by the majority and concurring Opinions is the latest expression of opinon by the United States Supreme Court in *Alabama Public Service Commission v. Southern Ry. Co., supra,* with reference to the scrupulous regard for the rightful independence of state governments which should at all times actuate the Federal Courts even in matters dealing with regulation rather than, as is the case in the instant appeal, the application of a non-discriminatory tax. (See, also, *Bird & Jex Co. v. Anderson Motor Co.,* 92 Utah 493, 69 P. 2d 510, cited in Appellant's Opening Brief at pages 30 and 31.)

As counsel indicated to the Honorable Court during the course of the lengthy oral presentation of this matter, the application of the California Sales and Use Tax Law with respect to liquidation sales made by trustees in bankruptcy is a matter of great concern not only to appellant but also to the bankruptcy referees and trustees in this jurisdiction. It was the sincere endeavor of counsel for appellant in their presentation of the instant appeal to present for the Court's full consideration all of the legal and factual issues involved in a situation which is fairly typical for the purpose of putting to rest once and for all the uncertainties involved. By failing to consider all the issues presented in the light of the cited decisions of

the United States Supreme Court and decisions in other Circuits, the Opinions rendered in the instant appeal would appear to indicate that in this Circuit, perhaps, a strict application of *McCulloch v. Maryland, supra* (see *Collector v. Day,* 11 Wall. 113, 20 L. Ed. 122), is still in order—although it would hardly appear at this late date, and especially in view of the decision in *Graves v. People of the State of New York, ex rel. O'Keefe, supra* (306 U. S. 466), that this Honorable Court so intended to infer.

Wherefore, petitioner respectfully urges that a rehearing be granted and that the mandate of this Court be stayed pending the disposition of this Petition.

Respectfully submitted,

California State Board of Equalization,

Edmund G. Brown,
Attorney General,

James E. Sabine,
Deputy Attorney General.

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Deputy Attorney General,

Attorneys for Appellant.

Certification.

I, Edward Sumner, Deputy Attorney General of the State of California, an attorney regularly admitted to practice in the United States Court of Appeals for the Ninth Circuit, do certify that in my opinion the foregoing Petition for Rehearing in the case of California State Board of Equalization, Appellant, v. George T. Goggin, Trustee in Bankruptcy of the Estate of West Coast Cabinet Works, Inc., Appellee, is well founded and is not presented for the purpose of creating a delay.

EDWARD SUMNER.

Nos. 12,728 and 12,729

IN THE

United States Court of Appeals

For the Ninth Circuit

ROLLINGWOOD CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DAVID D. BOHANNON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petitions for Review of Decisions of the Tax Court of the United States.

BRIEF FOR PETITIONERS.

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Nos. 12,728 and 12,729

IN THE

United States Court of Appeals

For the Ninth Circuit

ROLLINGWOOD CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DAVID D. BOHANNON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petitions for Review of Decisions of the Tax Court of the United States.

BRIEF FOR PETITIONERS.

JURISDICTION.

Petitioner, Rollingwood Corporation, (herein called "Rollingwood") and Petitioner, David D. Bohannon (herein called "Mr. Bohannon") each separately petitioned the Tax Court of the United States for a redetermination of the following alleged deficiencies:

1. In Income Taxes of Rollingwood for the fiscal years ending:

May 31, 1944	$ 1,406.58
May 31, 1945	$11,614.26
May 31, 1947	$28,237.35
Total	$41,258.19

2. In Excess Profits Taxes of Rollingwood for the fiscal years ending:

May 31, 1945	$ 3,315.26
May 31, 1946	$ 5,171.02
Total	$ 8,486.28

Mr. Bohannon is the transferee of Rollingwood. There is no issue here involved as to his individual tax liability.

The statutory provisions upon which the jurisdiction of the Tax Court and of this Court is based are Section 272 of the Internal Revenue Code, 26 U.S.C. 272, Section 1141(a) of the Internal Revenue Code, 26 U.S.C. 1141(a), as amended by Section 36 of the Act of June 25, 1948, C. 646, 62 Stat. 991, and Section 1142 of the Internal Revenue Code, 26 U.S.C. 1142.

Rollingwood filed its Petition for Redetermination with the Tax Court on August 19, 1948, within 90 days after Respondent mailed to it Respondent's notice of deficiency upon May 25, 1948, as alleged in its petition in paragraph II (R. 6, 112), and admitted by Respondent to be true in his answer. (R. 13.)

Mr. Bohannon filed his Petition for Redetermination with the Tax Court on August 19, 1948, within 90 days after Respondent mailed to him Respondent's notice of deficiency upon May 25, 1948, as alleged in his Petition in paragraph II (R. 102, 104), and admitted by Respondent to be true in his answer. (R. 111.)

The Tax Court entered its decision that there were deficiencies in income and excess profits taxes of Rollingwood as follows:

FISCAL YEAR	INCOME TAX	EXCESS PROFITS TAX
May 31, 1944	$ 1,406.58	$
May 31, 1945	12,316.61	3,315.26
May 31, 1946		5,171.02
May 31, 1947	28,237.35	
Total	$41,960.54	$ 8,486.28

against Rollingwood on July 17, 1950; and also entered its decision that there were the same amounts of liability due from Mr. Bohannon as transferee of the assets of Rollingwood against Mr. Bohannon on July 17, 1950. (R. 79, 115.)

Both Rollingwood and Mr. Bohannon upon October 9, 1950, filed with the Tax Court, separate Petitions For Review by The United States Court of Appeals For the Ninth Circuit of these decisions of the Tax Court. (R. 91-94, 118-123.)

QUESTION PRESENTED.

Rollingwood at the request of war industry built 700 defense houses in the Spring of 1943. These houses were advertised for rent prior to their completion; the United States Government required Rollingwood to rent all of them; and upon their completion on August 14, 1943 they were all rented to war workers under a written rental agreement committing Rollingwood to the rental of each and all of these houses for a period of thirty months and, in addition, granting to each tenant of Rollingwood an option to purchase the house in which he resided. During the taxable years here involved, Rollingwood (prior to its liquidation) sold all but four of these houses:

(a) Without engaging in any sales activities;

(b) Without displaying any "For Sale" signs on any of the properties involved;

(c) Without maintaining any sales force for the purpose of selling such properties;

(d) Without paying any sales commission on the sale of said houses;

(e) Without making any sale through a broker;

(f) Without engaging in any developmental activities.

The Respondent treated gains realized upon the sale of these houses as gains from the sale of property held primarily for sale to customers in the ordinary course of business, while Rollingwood treated them as gains from the sale of properties used in its trade or business but not of properties held primarily for sale to customers in the ordinary course of its business within the meaning

of Section 117(j) of the Internal Revenue Code. The sole issue is:

Should the gains from the sale of said defense houses be treated as gains from the sale of capital assets under Section 117(j) of the Internal Revenue Code?

STATUTES AND REGULATIONS INVOLVED.

Sections 117(a) and 117(j) of the Internal Revenue Code, 26 U.S.C. 117(a) and 117(j), and Section 29.117-7 (as amended by T.D. 5394, July 27, 1944) of Regulations 111 of the Bureau of Internal Revenue are set forth in Appendix A attached hereto.

STATEMENT OF THE CASE.

In 1942 and 1943 the industrial area surrounding the City of Richmond, California, was one of the most critical war effort areas in the United States. In said area there was a very serious manpower shortage, and a very serious lack of adequate housing which resulted in a very high turnover in civilian personnel engaged in war work. (Stipulation Paragraphs 8, 9, R. 24, 25.)

Mr. Clay Bedford, the General Manager of Shipyards Numbers One and Two of the Permanente Metals Corporation, Shipyard Number Three of Kaiser Company, Inc., and Shipyard Number Four of Kaiser Cargo, Inc., (hereinafter collectively referred to as "The Richmond Shipyards") requested Mr. Bohannon to sponsor

a privately owned war housing project in Richmond. Mr. Bohannon complied with this request and organized and formed the private war housing project of Rollingwood. (Stipulation Paragraphs 7, 10, 12, 14, R. 24, 25, 26.)

During the period in which the private war housing project of Rollingwood was being arranged and constructed, it was the policy of the Federal Housing Administration to encourage private enterprises to construct privately owned defense housing facilities and to encourage the rental thereof to war workers for the purpose of providing rental housing for defense workers so that they would not have to buy a house to stay on their jobs. These policies were communicated to Mr. Bohannon, the sponsor of the Rollingwood project, prior to the inception of the project of Rollingwood. Title VI of the National Housing Act, (added to the National Housing Act by an Act of March 28, 1941, C31, 55 stat. 55, as amended by an Act of May 26, 1942, C319, 56 stat. 301, 12 U.S.C. 1736 et seq.) provided the statutory authority for the expeditious building of defense housing and contemplated increasing the availability of rental housing. (Stipulation, Paragraph 13, R. 26, 27.)

Rollingwood was organized and incorporated under California laws on January 9, 1943, to build such a private war housing project in Richmond as requested by the Richmond Shipyards. Of the 50 shares of stock issued by Rollingwood, Mr. Bohannon purchased 26 and Ross H. Chamberlain 24. On May 10, 1945, Rollingwood reacquired the shares purchased by Ross H. Chamberlain and thereafter Mr. Bohannon was the sole stockholder

of Rollingwood. (Stipulation, Paragraphs 1, 4, and 10, R. 19, 20, 25.)

On October 3, 1942 and January 14, 1943, Mr. Bohannon applied to the National Housing Agency and the War Production Board for commitments and priorities sufficient to build 700 defense houses to make possible the Rollingwood project. Although Mr. Bohannon made these applications as an individual, he did so with a view towards the subsequent incorporation of Rollingwood and the assignment to it of such commitments and priorities as he might obtain. Such priorities and commitments were issued and later assigned to Rollingwood by Mr. Bohannon. (Stipulation, Paragraphs 13, 14, 15 and 17, and Exhibits 1 and 3, R. 26-30.) Rollingwood at the time of said assignments became bound by all conditions imposed upon and all agreements made by Mr. Bohannon in connection with said priorities. (Stipulation, Forms PD-708 attached as a part of Exhibits 2 and 4.)

Some of those conditions were that:

(a) Rollingwood was required to rent all of these defense houses and to grant to each tenant an option to purchase the house in which he resided.

(b) No initial payment could be required of a Tenant except the first month's rent.

(c) The option was required to run for a period of at least 30 months.

(d) The Tenant could not be obligated to purchase.

(e) Rollingwood could not dispose of any house other than in accordance with the required lease without the

prior approval of the Director of Industry Operations, War Production Board, Washington, D.C. (Stipulation Form PD-105, Exhibits 1 and 3.)

Said 700 defense houses were begun in the Spring of 1943, and all were completed on August 14, 1943. During the entire period of construction and until all were rented, Rollingwood displayed on the construction site two large signs setting forth the rent of these houses as a rent of $50.00 per month. (Stipulation, Paragraphs 21, 23, 24, R. 32, 34, 35.)

Shortly prior to their completion, on July 31, 1943, Rollingwood advertised these houses for rent at $50.00 per month. There was no mention in said advertisement of any possibility of any sale of any of said houses. (Stipulation, Paragraph 25, R. 35.)

All of these 700 houses were rented to war workers as rapidly as they were completed. A written rental agreement was executed by Rollingwood and each of Rollingwood's tenants. Under this rental agreement, Rollingwood agreed to be bound by the rental agreement for a period of 30 months, but the Tenant only agreed to be bound on a month to month basis. Each Tenant was given an option to purchase during the continuance of the agreement, which provided that the option price therein fixed would be reduced by the surplus of rent paid in excess of loan payments. In 1944 and subsequent years, some of said houses were re-rented without any option to purchase under a written rental lease agreement. (Stipulation, Paragraph 22, and Exhibits 5, 8, and 11, R. 32-34.)

The average period that these 700 houses were in fact rented was for a period of 22.9 months. (Stipulation, Paragraphs 22 and 28, Exhibit 11 and computations therefrom, R. 32, 37, 38.)

Rollingwood during its fiscal years ending May 31, 1944, 1945, 1946 and 1947, sold respectively, to tenants who elected to exercise the option contained in the initial rental agreement 4, 46, 211 and 15 houses, and to non-tenants 28, 175, 110 and 90 houses, and to tenants to whom the houses were re-rented without any option to purchase 0, 3, 0 and 8 houses. When liquidated on May 31, 1947, Rollingwood still owned 4 houses. (Stipulation, Paragraph 28, R. 37, 38, Exhibit 11, and computations therefrom.)

Rollingwood prior to its liquidation disposed of the houses involved in these proceedings:

(a) Without engaging in any sales activities;

(b) Without displaying any "For Sale" signs on any of the properties involved.

(c) Without maintaining any sales force for the purpose of selling said properties;

(d) Without paying any sales commission on the sale of any of said houses;

(e) Without making any sale through a broker;

(f) Without engaging in any development activities. (Stipulation, Paragraphs 21 and 25, R. 32, 35, 36, Exhibit 16.)

During the taxable years here involved, Mr. Bohannon, the President of Rollingwood, devoted substantially his

entire time and energy to the private war housing projects of Rollingwood, Pacific Homes, Inc., Western Homes, Inc., and Greenwood Corporation. Prior to Pearl Harbor, Mr. Bohannon was in the real estate business and in the business of subdividing and selling real property. In addition, he was and still is the sole stock holder in Suburban Builders, Inc., which prior to December 7, 1941, was engaged in the business of a general contractor and the business of constructing and selling homes in San Mateo County, California. (Stipulation, Paragraphs 34, 35, 37, 38, R. 39, 40, 41.)

Shortly after Pearl Harbor, Mr. Bohannon disbanded his sales force, thereafter maintained no sales force, thereafter engaged in no advertising, in no land development, and in no sales programs. He caused Suburban Builders, Inc., shortly after Pearl Harbor to complete such work as it then had in progress and thereafter to undertake no further work. Mr. Bohannon did maintain his real estate broker's license during the war and at all times herein mentioned. (Stipulation, Paragraphs 35 and 36, R. 40.)

Respondent determined that the defense houses disposed of by Rollingwood were held primarily for sale to customers in the ordinary course of business and treated the gains of Rollingwood on such disposition as ordinary income.

The sole issue is whether these houses were held by Rollingwood primarily for sale to its customers in the ordinary course of its business within the meaning of Section 117(j) of the Internal Revenue Code.

SPECIFICATIONS OF ERROR.

1. The Tax Court erred in holding and deciding that the gains realized by Rollingwood from the sale of the houses involved in these proceedings were ordinary income derived from the sale of property held primarily for sale to customers in the ordinary course of business within the meaning of Section 117(j) of the Internal Revenue Code, and not gains from the sale of capital assets in accordance with the provisions of Section 117(j) of the Internal Revenue Code.

2. The Tax Court erred in not holding and deciding that the gains realized by Rollingwood on the sale of the houses involved in these proceedings should be treated as gains from the sale of capital assets in accordance with the provisions of Section 117(j) of the Internal Revenue Code.

3. The Tax Court erred in making the finding of fact (contrary to the facts stipulated to be true by Respondent and Rollingwood) that the houses involved in these proceedings were held by Rollingwood primarily for sale to customers in the ordinary course of business. Said finding of fact is erroneous because it constitutes: (a) an erroneous conclusion of law rather than of fact, and (b) the only finding or conclusion which could be made or reached upon the basis of the facts stipulated by Respondent to be true and found to be true by the Tax Court is that these houses were never held by Rollingwood primarily for sale to its customers in the ordinary course of business.

4. The decisions entered by the Tax Court herein are contrary both to the provisions of Section 117(j) of the

Internal Revenue Code and the Tax Court's findings of fact and the evidence, all of which was stipulated by Respondent to be true; and is not supported by said findings of fact or the evidence, and is in disregard of both said findings of fact and the evidence.

5. The Tax Court, in disregard of its findings of fact (i.e., the facts stipulated in writing by Respondent and Rollingwood to be true) erred in failing to include in its findings of fact and in failing to find that all houses involved in these proceedings were built and acquired by Rollingwood for rental and not primarily for sale to customers in the ordinary course of business.

6. The Tax Court, in disregard of its findings of fact (i.e., the facts stipulated in writing by Respondent and Rollingwood to be true) erred in including in its findings of fact and in finding as follows, that:

> "David D. Bohannon has for many years, including the years in question, been actively engaged in the real estate business in California."

Said finding of fact is erroneous in that it is not supported by the evidence and is contrary to and inconsistent with the other findings of fact of the Tax Court (i.e., the facts stipulated in writing by Respondent and Rollingwood to be true).

7. The Tax Court, in disregard of its findings of fact (i.e., the facts stipulated by Respondent and Rollingwood in writing to be true) erred in failing to include in its findings of fact and in failing to find that Mr. Bohannon changed his occupation shortly after December 7, 1941, from the business of building houses for sale to

the business of sponsoring and managing the construction and operation of privately owned war housing projects for rental to defense workers in which business he continued and to which he devoted substantially his entire time and attention, throughout all times involved in these proceedings.

8. The Tax Court, in disregard of its findings of fact (i.e., the facts stipulated by Respondent and Rollingwood in writing to be true) erred in failing to include in its findings of fact and in failing to find that Rollingwood (prior to its liquidation) disposed of all the houses involved in these proceedings, which were upon their construction and acquisition capital assets, without Rollingwood:

(a) ever engaging in any sales activities;

(b) ever displaying any "For Sale" signs on any of the properties involved;

(c) ever maintaining any sales force for the purpose of selling said properties;

(d) ever paying any sales commission on the sale of any of said houses;

(e) ever making any sale through a broker;

(f) ever engaging in any developmental activities.

9. The Tax Court, in disregard of its findings of fact (i.e., the facts stipulated by Respondent and Rollingwood to be true) erred in failing to include in its findings of fact and in failing to find that Rollingwood, prior to its liquidation, passively liquidated all of the houses involved in these proceedings, and that upon their acquisi-

tion and at all times thereafter they were capital assets within the meaning of Section 117(j) of the Internal Revenue Code.

10. The Tax Court erred in not holding that the deficiencies determined by the Respondent against Rollingwood and Mr. Bohannon should be redetermined so that the tax liability of Rollingwood can be established by treating the gains realized by Rollingwood on the sale of the houses involved in these proceedings as gains from the sale of capital assets within the meaning of Section 117(j) of the Internal Revenue Code.

ARGUMENT.

I. SUMMARY.

A. These cases were submitted solely upon a written stipulation of facts. There was no oral testimony. The sole issue is a matter of statutory interpretation and application and the determination of the proper conclusions of law from the stipulated record. This Court is therefore not bound by either the findings or conclusions of the Tax Court, and under the decisions of this Court, this Court will examine the stipulated record, make its own findings and reach its own conclusions.

B. In the Spring of 1943 Rollingwood acquired and constructed 700 defense houses. These houses were acquired and constructed:

(a) for rental and income producing purposes; and

(b) as a part of the housing program of the United States Government to create and make available

rental housing to in-migrant war workers in critical areas.

C. As rapidly as completed each of the 700 houses was leased to an in-migrant war worker for a period of thirty (30) months with the right in the tenant at his option to purchase.

D. On completion of the 700 houses and the entire project of Rollingwood on August 14, 1943, all of the 700 houses were so leased.

E. The average period of rental and occupancy by tenants of the houses involved in these appeals was 22.9 months per house.

F. Rollingwood advertised said houses for rent and expended $5,432.53 in such advertising.

G. The priorities issued by the United States Government pursuant to which said houses were acquired and built, prohibited the sale thereof to anyone other than the tenant without special permission of the Federal Government.

H. Rollingwood, as a corporation, was liquidated on May 31, 1947, and prior to its liquidation, it disposed of all but four of said houses under circumstances which, in view of the Court decisions construing the statute involved, including those of the Tax Court and this Court, would not convert such houses from capital assets into assets held primarily for sale to customers in the ordinary course of its business, i.e., in the sale thereof Rollingwood:

(a) never engaged in any activities to promote sales:

(b) never displayed any "For Sale" signs on any of the properties involved:

(c) never maintained any sales force for the purpose of selling said properties;

(d) never paid any sales commissions on the sale of any of said houses;

(e) never made any sale through a broker;

(f) never engaged in any developmental activities after the rental thereof.

I. Mere frequency and continuity of sales of capital assets not accompanied by any sales activities and property development will not,—under the decisions of this Court,—convert capital assets into properties held primarily for sale to customers in the ordinary course of business.

J. All of the houses here involved were capital assets when acquired and constructed and remained capital assets during the passive liquidation thereof and while Rollingwood was selling itself out of the rental business.

II. THIS COURT MAY INDEPENDENTLY AND FULLY REVIEW THE CONCLUSIONS OF THE TAX COURT BECAUSE THE ISSUE HERE IS A MATTER OF STATUTORY INTERPRETATION, I.E. A QUESTION OF LAW, AND A FUNCTION OF THIS COURT AS WELL AS THE TAX COURT.

Although it is true that in 1936, in *Richards v. Commissioner,* 81 F. 2d 369 (1936), this Court said:

> "The Board determined the ultimate fact to be: '* * * That the lots were held by the petitioner primarily for sale in the course of his business. * * *'

> We are limited therefore to an examination of the record to ascertain whether or not there is any substantial evidence to sustain the finding."

the rule of law has, however, now been settled by this Court that the findings and the conclusions of the Tax Court upon the question whether properties are held primarily for sale to customers in the ordinary course of business are subject to independent judicial review.

In *Commissioner v. Boeing,* 106 F. 2d 305 (1939), where the scope and nature of review of this court upon the question herein involved were carefully examined, this Court expressly overruled the *Richards* case and its supporting decisions on this point, and squarely held at 308:

> " 'Respondent has cited decisions of the Circuit Court of Appeals, some of which are apparently in conflict with the above cited cases. He calls our attention to three decisions by our own circuit, Tricou v. Helvering, 68 F. 2d 280, 9 Cir., 1933; Winnett v. Helvering, 68 F. 2d 614, 9 Cir. 1934, and Richards v. Commr., 81 F. 2d 369, 106 A. L. R. 249, 9 Cir. 1936. But these cases must be read in light of the more recent expressions of the final court.
>
> We think that the ultimate findings of the Board above referred to in this case are conclusions of law or mixed questions of law and fact within the meaning of the Supreme Court rulings and as such are subject to independent judicial review by this Court.' " (Emphasis added.)

The question presented to this Court is the interpretation of Section 117 (j) of the Internal Revenue Code, i.e.,

whether properties were held primarily for sale to customers in the ordinary course of business, within the meaning of that Statute, and as such is obviously within the province and jurisdiction of this Court.

III. THIS COURT SHOULD REACH ITS OWN CONCLUSIONS WITHOUT REGARD TO THE FINDINGS OF FACT OF THE TAX COURT BECAUSE ALL FACTS IN THESE CASES WERE STIPULATED IN WRITING BY THE PARTIES THROUGH THEIR ATTORNEYS.

Petitioners contend that this Court has clearly settled the law as to the scope of review on the question before this Court. There is, however, an additional reason for this Court to reach its own conclusions in these cases without regard to the findings and conclusions of the Tax Court.

All of the facts in these cases were stipulated in writing by the parties through their respective attorneys. No additional evidence, by way of oral testimony or otherwise, was presented to the Tax Court at the hearing.*

The United States Courts of Appeals now review appeals from the Tax Court in the same manner in which they review cases appealed from the District Courts, sitting without juries, as a result of the amendment to Section 1141 (a) of the Internal Revenue Code, 26 U.S.C. 1141 (a), by an Act of June 25, 1948, C646, Section 36, 62 Stat. 991, which provides as follows:

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*This Stipulation, except for certain exhibits excluded from printing by the order of this Court, is printed at page 18 through page 52 of the Record.

> "(a) Jurisdiction: The courts of appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, * * * *in the same manner* and *to the same extent* as decisions of the district courts in civil actions tried without a jury; * * *." (Emphasis added.)

The Federal Courts, since the enactment in 1938 of the Federal Rules of Civil Procedure, review findings of fact in cases appealed from the District Courts, sitting without juries, in a uniform manner, whether the action is one at law or equity, in accordance with the prevailing Federal Equity practice at the time of the adoption of the Federal Rules of Civil Procedure. In *United States v. United States Gypsum Co.*, 333 U.S. 364 (1948) at page 394, the Supreme Court held that by the adoption of the Federal Rules of Civil Procedure:

> "It was intended, in all actions tried upon the facts without a jury, *to make applicable the then prevailing equity practice.*" (Emphasis added.)

The Federal Equity Courts have always drawn their own inferences from evidence which was purely documentary in character, such as where the evidence is contained in writing, or in depositions, or where the facts are stipulated in writing by the parties. Especially is this true where the facts are stipulated.*

This Court has squarely held that a full review is to be granted an appellant where all of the evidence is docu-

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*In the Federal Equity Rules of 1912, Rule 46 provided that the testimony of witnesses in equity shall be orally in open court, rather than by way of deposition, except in certain limited cases. Subsequent to this, equity adopted self denying rules of review where the testimony was orally received but the review was always full where the testimony was by way of deposition or based upon written instruments.

mentary in character by way of depositions. In *Equitable Life Assurance Society v. Irelan,* 123 F. 2d 462 (1941), where the issue was whether death by drowning was accidental or suicidal in character (purely a question of fact), and where the evidence was in the form of depositions, this Court reversed a finding of fact of the trial court, holding, at page 464:

> "Since all testimony bearing on the circumstances antecedent to and surrounding her death was by deposition, the finding of accidental death, while it is justly entitled to consideration, has not the weight we would otherwise be obliged to concede to it. This court is in as good a position as the trial court was to appraise the evidence and we have the burden of doing that. Rule 52(a) of the Rules of Civil Procedure, 28 U.S.C.A., following Section 723c, was intended to accord with the decisions on the scope of review in federal equity practice; and, as is well known, in the federal courts where the testimony in equity or admiralty cases is by deposition the reviewing court gives slight weight to the findings." (Emphasis added.)

In *Pacific Portland Cement Co. v. Food Machinery Corp.,* 178 F. 2d 541 (1949), this Court clearly expressed the general rule, as follows at 548:

> "As to this, we are faced with the mandate of Rule 52(a) of the Federal Rules of Civil Procedure, which bids us not to set aside findings unless they are 'clearly erroneous.' Federal Rules of Civil Procedure, Rule 52(a). Under the interpretation which the Supreme Court, and this and other courts of appeal, have placed upon this section, the findings of a trial judge will not be disturbed if supported by substan-

tial evidence. Full effect will always be given to the opportunity which the trial judge has, *denied to us,* to observe the witnesses, judge their credibility, and draw inferences from contradictions in the testimony of even the same witness. Savage v. Lorraine, 9 Cir., 1945, 148 F. 2d 818; Augustine v. Bowles, 9 Cir. 1945, 149 F. 2d 93, 96; Lincoln National Life Ins. Co. v. Mathisen, 9 Cir., 1945, 150 F. 2d 292, 295-296. This in the meaning of the provision that findings should not be set aside unless clearly erroneous. Grace Bros. v. Commissioner, 9 Cir., 1949, 173 F. 2d 170, 173-174. In contrast, the Supreme Court has told us that, 'A finding is "clearly erroneous" when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.' United States v. United States Gypsum Co., 1948, 333 U.S. 364, 395, 68 S. Ct. 525, 542, 92 L. Ed. 746. (Court's emphasis.)

As a corollary to this rule, we may make our own inferences from undisputed facts or purely documentary evidence. For, to use the colorful language of the Court of Appeals for the Third Circuit, the rule does not operate 'to entrench with like finality the inferences or conclusions drawn by the trial court from its fact findings.' Kuhn v. Princess Lida of Thurn & Taxis, 3 Cir., 1941, 119 F. 2d 704, 705. And see Western Union Tel. Co. v. Bromberg, 9 Cir., 1944, 143 F. 2d 288, 290; Home Indemnity Co. v. Standard Accident Ins. Co., 9 Cir., 1948, 167 F.2d 919, 922, 923." (Emphasis added.)

In a federal taxation case presented by an appeal by Joseph T. Higgins, the Collector of Internal Revenue for

the Third District of New York, the United States Court of Appeals for the Second Circuit, in *Orvis v. Higgins,* 180 F. 2d 537 (1950), Certiorari denied by the Supreme Court, 340 U. S. 810, commenting on the *Gypsum* case, supra, 333 U.S. 364, pointed out that a trial judge's finding does not have the dignity which jury verdicts derive from the Constitution nor the dignity which some statutes confer on findings of some administrative agencies, stating at p. 539:

> "In the light of the Gypsum case, we may make approximate gradations as follows: We must sustain a general or a special jury verdict when there is some evidence which the jury might have believed, and when a reasonable inference from that evidence will support the verdict, regardless of whether that evidence is oral or by deposition. In the case of findings by an administrative agency, the usual rule is substantially the same as that in the case of a jury, the findings being treated like a special verdict. Where a trial judge sits without a jury, the rule varies with the character of the evidence: (a) If he decides a fact issue on written evidence alone, we are as able as he to determine credibility, and so we may disregard his finding. (b) Where the evidence is partly oral and the balance is written or deals with undisputed facts, then we may ignore the trial judge's finding and substitute our own, (1) if the written evidence or some undisputed fact renders the credibility of the oral testimony extremely doubtful, or (2) if the trial judge's finding must rest exclusively on the written evidence or the undisputed facts, so that his evalution of credibility has no significance. (c) But where the evidence supporting his finding as to any fact issue is entirely oral testimony, we may disturb

that finding only in the most unusual circumstances." (Emphasis added.)

The United States Court of Appeals for the District of Columbia, in *Dollar v. Land,* 184 F. 2d 245 (1950), clearly followed the *Orvis v. Higgins* decision, supra, 180 F.2d 537. There the Court reversed a finding by the District Court that the transfer of the stock of the Dollar Steamship Lines to the United States Maritime Commission was absolute and not by way of pledge, *granting a full review* where the finding was based upon documentary evidence or undisputed facts.

In *Wigginton v. Order of United Commercial Travelers,* 126 F.2d 659 (1942), certiorari denied, 317 U.S. 636, where all facts were stipulated, the Circuit Court of Appeals for the Seventh Circuit, at page 661, held:

> "Since the facts are not in dispute, we are free to consider them and to reach our own conclusion, untrammeled by the District Court's findings and conclusions of law. Especially is this rule applicable in the case at bar, where all the facts are stipulated." (Emphasis added.)

The only dispute between the parties here is with respect to the inferences or conclusions to be drawn from undisputed facts, i.e., facts which were stipulated, found to be true by the Tax Court, and included within the Tax Court's Findings of Fact. This disputed Conclusion is whether or not these houses were held primarily for sale to customers in the ordinary course of business within the meaning of section 117(j) of the Internal Revenue Code.

Where the facts are undisputed, and the only question is as to the application of the statute, this conclusion is

a matter of statutory interpretation and a proper function of this Court. The Tax Court's inclusion of a finding of fact to this effect in its findings cannot deprive petitioner of the consideration by this Court of whether or not the statute is applicable.

But assuming solely for argumentative purposes that there is any element of fact contained in the Tax Court's decision, this Court is free to draw its conclusions in accordance with the uniform federal equity practice from facts which are both (a) undisputed evidentiary facts and (b) are entirely set forth in a written Stipulation of Facts.

IV. THE HOUSES INVOLVED IN THESE CASES WERE NOT BUILT OR ACQUIRED PRIMARILY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF BUSINESS BECAUSE THEY WERE BUILT AND ACQUIRED FOR RENTAL.

A. Rollingwood announced and advertised that these houses were for rent during the entire period of their construction.

During the entire period of construction of the defense houses built by Rollingwood and until all were rented (a period of several months), Rollingwood displayed on the site of this war housing project, in a conspicuous location, two large signs setting forth the rent of these houses as a rent of $50.00 per month. (Stipulation, Paragraphs 23, 24, R. 34, 35).

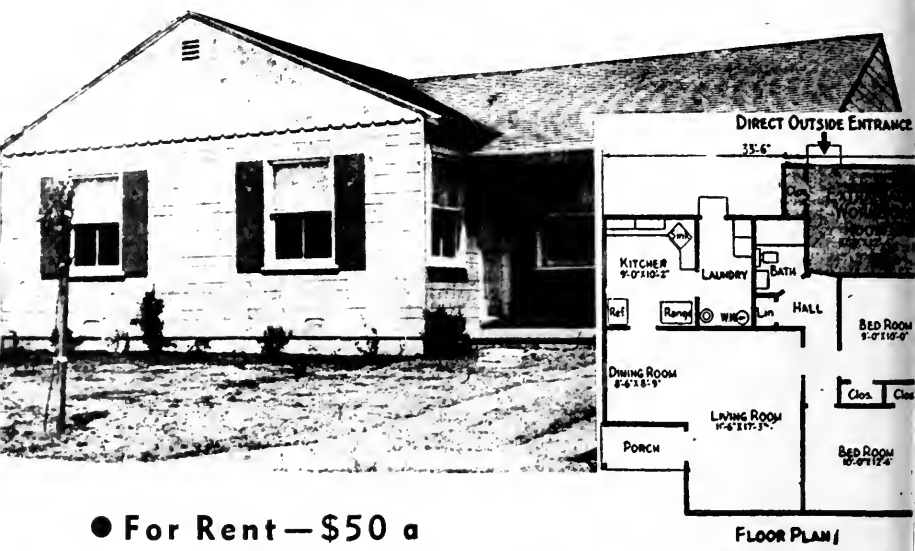
These signs were of dimensions greater than 2½ feet by 4 feet and of such a character that the words *therein were legible at a distance of 100 feet.* (Stipulation, Paragraphs 23, 24, R. 34, 35).

Homes for War Workers

NOW AVAILABLE IN

ROLLINGWOOD

THE MODEL COMMUNITY OF RICHMOND



FLOOR PLAN

- For Rent—$50 a Month New 3 Bedroom Homes
- Regular Bus Service To Shipyards
- School Nearby
- Fully Landscaped
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Childhood Gets No Second Chance --- ACT NOW!

Call at our Office, West Side of Ninth Street, between Macdonald Avenue and Nevin, opposite Kaiser Hiring Hall. Courteous Attendants Will Drive You to the Rollingwood Tract, Located Near Intersection of Twenty-third and San Pablo Avenue, Richmond.

ROLLINGWOOD CORP.

TELEPHONE RICHMOND 4448

B. Prior to the completion and the rental of all of these houses Rollingwood advertised these defense houses for rent.

On July 31, 1943 (approximately two weeks before the completion of all of said houses) Rollingwood advertised said houses for rent by an advertisement (Stipulation, Paragraph 25, Exhibit 9, R. 35, 52), which for convenience petitioners have reprinted opposite:

In said advertisement there was no mention whatsoever of any possibility of any sale of any of said houses. The announced and advertised intention of Rollingwood with respect to these houses was that they were only "For Rent". This intention was so manifested at a time when petitioners were obviously concerned with building houses as rapidly as possible as their contribution to the war effort and not with any tax consequences of their acts.

C. A most critical war industry, and not petitioners, initiated this defense housing project.

The Mare Island Navy Yard, Shipyards Numbers One and Two of the Permanente Metals Corporation, Shipyard Number Three of Kaiser Company, Inc., and Shipyard Number Four of Kaiser Cargo, Inc. (known collectively as the "Richmond Shipyards") were in operation in the Richmond industrial area when this project was requested. In addition, said area, included refineries of the Standard Oil Company of California, Shell Oil Company and Union Oil Company, the Hercules Powder Company, and numerous other essential war industrial enterprises. (Stipulation, Paragraph 7, R. 24).

Mr. Clay Bedford, the General Manager of the Richmond Shipyards, requested Mr. Bohannon to sponsor the defense housing project which was constructed by Rolling-

wood. At the time of his request he knew of the defense housing project at Napa, California, which Mr. Bohannon had also sponsored and managed. He advised Mr. Bohannon that he could make no greater contribution to the war effort than to sponsor the requested defense housing project. In that connection Mr. Bedford advised Mr. Bohannon that:

> "* * * if adequate war housing were made available, it would substantially lessen the serious loss of leadermen and key personnel in the Richmond Shipyards which was being experienced at that time, and that at that time the Richmond Shipyards were bringing workmen from various parts of the United States to Richmond and that due to the lack of housing such workmen would not bring their families and would not themselves stay in the City of Richmond." (Stipulation, Paragraph 10, R. 25).

D. This project was undertaken and completed in accordance with the policy of the United States Government to encourage the construction of defense houses for rent.

At the time this project was initiated and organized, it was the policy of the Federal Housing Administration to encourage private enterprises to construct privately owned defense housing facilities and to encourage the rental thereof to war workers for the purpose of providing rental housing for defense workers so that they would not have to buy a house to stay on their jobs. This policy was communicated to Mr. Bohannon by officials of the Federal Housing Administration prior to the inception of the Rollingwood project.

Title VI of the National Housing Act, (added to the National Housing Act by an Act of March 28, 1941, C31, 55 Stat. 55 as amended by an Act of May 26, 1942, C319,

56 Stat. 301, 12 U.S.C. 1736 et seq.) provided the Congressional Authority for expediting defense housing and contemplated increasing the availability of rental properties. (Stipulation, Paragraph 13, R. 26, 27).*

To make possible the proposed Rollingwood war housing project, it was necessary to obtain the approval of the National Housing Agency and to obtain from the War Production Board priorities for all critical building materials necessary for said project. (Stipulation, Paragraphs 11, 14, R. 26, 27.)

Mr. Bohannon made two applications to the War Production Board for the necessary priorities covering the critical materials required in the construction of the 700 houses here involved. Although Mr. Bohannon made these applications as an individual, he did so only with the intention of the subsequent incorporation of Rollingwood and the assignment to it of such commitments and priorities as he might obtain. The first application was filed October 3, 1942, with respect to 400 houses, and the second application was filed January 14, 1943, with respect to 300 houses. (Stipulation, Paragraphs 14, 15, 17 and Exhibits 1 and 3, R. 27, 28, 29, 30.)

Both applications were processed and approved by the National Housing Agency (acting through the Federal Housing Administration) and by the War Production Board. (Stipulation, Paragraphs 15, 17, R. 28, 29, 30.)

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*Pursuant to Congressional Authority, on February 24, 1942, Executive Order No. 9070, 50 U.S.C.A. App. Section 601, page 206, 7 F.R. 1529, consolidated the major agencies dealing with housing, including the Federal Housing Administration, into a National Housing Agency to be administered by a National Housing Administrator. One of the three main units of this agency was the Federal Housing Administration administered by the Federal Housing Commissioner.

E. The conditions imposed by the United States Government on the issuance of said priorities necessitate a finding that said houses were built and acquired for rental and not primarily for sale to customers in the ordinary course of business.

Rollingwood was bound by all conditions imposed upon Mr. Bohannon and all agreements made by him in connection with the issuance of said priorities. (Stipulation, Forms PD 708 attached to and forming a part of Exhibits 2 and 4.)

By reason of said conditions and agreements:

1. Rollingwood was required to rent said houses and to grant to each tenant an option to purchase.

2. No initial payment could be required of a tenant, except the first month's rent.

3. No monthly payment could exceed rental for equivalent accommodations.

4. A period of at least 30 months was required to be given to the tenant to accumulate an equity to apply on the option price of the house in which he resided.

5. The tenant *could not be obligated to purchase.* (Stipulation Forms PD-105, Exhibits 1 and 3.)

F. The actual renting of all of said houses by Rollingwood, the manner in which it rented said houses and the manner in which it conducted its business necesitate a finding that said houses were built for rental and not primarily for sale to customers in the ordinary course of business.

These houses were begun in the Spring of 1943 and all were entirely completed and ready for occupancy on August 14, 1943. Rollingwood as rapidly as possible as each house was completed then in fact rented every one of

ADDITIONAL PROVISIONS

1. The property covered by this agreement is described as follows:

2. If the dwelling on the property is under construction at the time this agreement is executed, the rental shall commence on the date that Rollingwood Corp. can deliver possession of the property.

3. No alterations of any kind to the dwelling shall be made without the prior written consent of Rollingwood Corp.

4. The renters shall pay for all utility services furnished to the property.

5. The renters shall keep the property in first-class condition and shall pay for all repairs.

6. The renters shall not have the right to sublet the property or to assign this agreement or any interest in the property without the prior written consent of Rollingwood Corp.

7. The FHA payments referred to herein shall include all payments made on account of principal, interest, fire insurance, taxes, FHA mortgage insurance and all other FHA charges.

8. The option to purchase granted to the renters, shall be conditioned upon the renters being acceptable to the FHA as borrowers in lieu of Rollingwood Corp. and shall be subject to any conditions imposed by the War Production Board.

9. The option to purchase shall expire on the first to occur of the following: (a) surrender of possession by the renters; or (b) the expiration of thirty months from date; or (c) default by the renters which remains unremedied for ten days after notice given to the renters by mail addressed to them at No. ..... Avenue, Rollingwood, Calif.

10. Rollingwood Corp. shall have the right to inspect homes at any time.

Furthermore, Rollingwood Corporation had by this form of agreement committed all of said 700 houses to rental for the period of 30 months.

G. The granting of an exclusive option to purchase to the occupant of each house itself strengthens the conclusion that Rollingwood was not primarily interested in the sale of these houses.

As each of the 700 houses was completed and rented each tenant was granted an exclusive option lasting for 30 months to purchase the house in which he resided. (Stipulation, Paragraph 22, Exhibit 5, R. 32, 49.) This exclusive option eliminated from the entire field of potential purchasers all but the single occupant residing in each house and thus restricted the market of potential purchasers to a single person.

If Rollingwood were primarily interested in the sale of these houses, it seems inconceivable that it would have placed itself in a position where it could not sell any house except to the single tenant residing therein and only in the event of his desire to purchase (except for a purely theoretical sale subject to the option).

Especially is this true when as here the tenants of Rollingwood were in-migrant war workers,* a class from whom it could hardly have been forecast by Rollingwood at a date early in World War II, that many potential purchasers would come. (Stipulation, Paragraph 22, R. 32.)

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*In-migrant war workers were those war workers whose in-migration from beyond the distance of feasible transportation into localities of intensive war production was indispensable to augment the local labor supply. See National Housing Agency Order 60-1, Sections 1.02 and 3 set forth in Exhibit 12.

H. These houses were rented for an average period of 22.9 months.

The approximate length of time which each of these houses was in fact rented is set forth on Exhibit 11. Based on a pure mathematical computation, the average period during which these houses were in fact rented was 22.9 months. This is a *substantial* period of rental which should not be disregarded and which conclusively shows that Rollingwood carried out and fulfilled its purpose of building and acquiring houses for rental.

Petitioners submit that the evidence hereinabove discussed makes it abundantly clear that Rollingwood built and acquired these houses for rental, that it placed the possession, use, and ability to sell these houses beyond its power for a period of thirty months.

I. Not only was Rollingwood a project for the building of houses for rental but, also, Mr. Bohannon during the war discontinued all of his personal activities in land development, all of his sales programs, and all of his sales activities.

It is true that prior to December 7, 1941, Mr. Bohannon was in the real estate business primarily in the County of San Mateo, State of California. Shortly after December 7, 1941, however, he disbanded his sales force and thereafter maintained no sales force. He thereafter engaged in no advertising, and in no land development and in no sales programs. (Stipulation, Paragraphs 34, 35, R. 39, 40.)

In addition to the discontinuance of all of his personal activities with respect to land development, he caused Suburban Builders, Inc., which prior to December 7, 1941 had been in the business of building houses for sale, to

discontinue all of its building of homes and sales activities. Thereafter he devoted his entire time and attention to the private war housing project of Rollingwood and other private war housing projects. (Stipulation, Paragraph 35, R. 40.)

No doubt the Respondent will attempt to taint Rollingwood with Mr. Bohannon's pre-war activities, and the fact that Mr. Bohannon kept in force during the war his brokerage license.

Any finding that Rollingwood was holding these houses primarily for sale to customers in the ordinary course of business must of necessity have been based on inferences from facts not within this record, and contrary to the facts stipulated to have been true. Not only are Rollingwood and Mr. Bohannon separate taxable entities, but Mr. Bohannon himself in his personal business discontinued during World War II, and all times material to these proceedings, all aspects of his pre-war real estate and land development activities. During this time he devoted himself exclusively to private war housing projects such as the Rollingwood Project.

Rollingwood announced and advertised that these houses were for rental; it entered into written rental agreements with respect to each and every house; it granted to each of its tenants an exclusive option to purchase the house in which he resided; it placed the possession, control and ability to sell these houses beyond its power for a period of thirty months. These facts make it abundantly clear that Rollingwood built and acquired these houses for rental.

V. THESE HOUSES WERE NEVER HELD PRIMARILY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF BUSINESS BECAUSE THE MERE FREQUENCY AND CONTINUITY OF SALES OF CAPITAL ASSETS BY ITSELF HAS NEVER BEEN HELD TO BE SUFFICIENT TO CHANGE THE CHARACTER OF CAPITAL ASSETS INTO ASSETS HELD PRIMARILY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF BUSINESS.

A. **The sale of these houses which the evidence conclusively shows to have been built for rental rather than to have been built primarily for sale to customers in the ordinary course of business was accompanied by no extended development—in fact, no development and no sales activities of any kind.**

It was stipulated in the Stipulation of Facts that all development work was completed on August 14, 1943. (Stipulation, Paragraphs 6 and 21, R. 23, 32.) Paragraph 21 of the Stipulation of Facts (R. 32) reads as follows:

> "The work of preparing the Rollingwood Tract for use in said project of Rollingwood Corporation and the work of constructing and completing said seven hundred (700) houses was commenced during the Spring of 1943, and all of said seven hundred (700) houses were completed on August 14, 1943, the entire project having been fully performed within six hundred ninety-three (693) elapsed working hours after the first ground breaking on the Rollingwood Tract." (Emphasis added.)

Since, therefore, all subdivision work, all construction work and all development work was completed on August 14, 1943, there was nothing remaining for Rollingwood to do in the development of its properties and on that date every house was rented for thirty (30) months.

Rollingwood rented each and all of said 700 houses and committed itself to the rental of each thereof for a period

of thirty months. By taking the entire period of all rentals and dividing the same by the number of houses, it appears that said 700 houses were rented for an average of 22.9 months each.

Rollingwood did not thereafter engage in any sales activities or in any development of its properties which, under the decisions, would justify any holding except a holding that its properties were upon their acquisition and at all times thereafter capital assets.

Rollingwood at no time displayed any "For Sale" signs on any of the houses involved in these cases. (Stipulation, Paragraph 25, R. 35, 36.)

Rollingwood never displayed any "For Sale" signs on the Rollingwood Tract. (Stipulation, Paragraph 5, R. 35.)

Rollingwood never had any sales force for the purpose of selling said houses. (Stipulation, Paragraph 25, R. 35.)

Rollingwood never paid any sales commission on the sale of any of said houses. (Stipulation, Paragraph 25, R. 35, 36.)

Rollingwood never made any sale whatsoever through a broker, (Stipulation, Paragraph 25, R. 36) and all sales were handled by Rollingwood's manager and his assistants who were enployed on a salary basis.

Rollingwood, following the completion of the construction of its project on August 14, 1943, never engaged in any developmental activities with respect to the Rollingwood Tract, or said project. (Stipulation, Paragraphs 6, 21, R. 23, 32.)

After the completion of these houses and its private war housing project on August 14, 1943, Rollingwood never subdivided, improved or in any other way developed its properties. (Stipulation, Paragraph 21, R. 32.)

B. Rollingwood expended more than $5000 in advertising said houses for rental.

It is stipulated in "Exhibit 16" of the Stipulation of Facts that Rollingwood expended in advertising said houses for rental the following amounts:

Fiscal Year Ended May 31	Amount For Such Fiscal Year
1944	$4,442.97
1945	989.56
1946	0
1947	0

All of said advertising expenses were included in rental expenses and charged against Rollingwood Corporation's gross rental income. (Stipulation, "Exhibit 16", Paragraph 30, R. 39.)

It is inconceivable that a corporation, holding real property primarily for sale to customers in the ordinary course of business, would have expended $5,432.53 in advertising its properties for rent, or that it would have published the advertisement set forth as "Exhibit 9" of the Stipulation of Facts and at page 25 of this Brief.

C. The courts have only applied the frequency and continuity tests to convert an asset which is acquired as a capital asset into an asset held primarily for sale to customers in the ordinary course of business where substantial developmental or sales activities accompanied such sales.

In the leading case decided by this Court of *Richards v. Commissioner,* 81 F. 2d 369 (1936), properties which

were acquired and purchased as farming property, i.e. clearly capital assets upon their acquisition, were held to have been converted into assets held primarily for sale in the course of business by a sub-division of those properties by the taxpayers. The Court stated at 370:

> "Petitioner concedes that he subdivided his real property and held it thereafter primarily for sale, * * *"

Commenting on the effect of such a subdivision, this Court said at 373:

> "It is quite obvious that the reason petitioner subdivided the land for sale was to obtain a larger profit."

Although the word "held" includes properties which at one period were capital assets and which have had their classification changed subsequent to their acquisition to that of property held primarily for sale to customers in the ordinary course of business, petitioners vigorously urge that this Court has never indicated or held that nothing more than a mere frequency and continuity of sales is needed for such a conversion.

In the other leading case in this field, *Ehrmann v. Commissioner,* 120 F. 2d 607 (1941), taxpayers again were held to have changed the character of capital assets into assets held primarily for sale to customers in the ordinary course of business by a subdivision.

Furthermore, both of these cases involved typical Southern California subdivision trusts where extensive selling activities were entrusted to exclusive real estate sales agents. The contract between the owners and the real estate agents in the *Ehrmann* case provided for a

selling commission of 28% of the gross sales price to be paid the agent. In return it agreed to "* * * organize and train an efficient sales organization to carry on an extensive and intensive advertising and selling compaign, * * *" (From the Findings of Fact of the Board, 41 BTA 652, at 657.) (Underscoring added.)

In the *Richards* case, supra, 81 F.2d 369, the taxpayer subdivided his property into about 400 lots. He employed an exclusive sales agent—a real estate man who was to subdivide the property, and was to solicit and obtain purchasers. The taxpayer agreed to pay him real estate commissions out of which he was to pay advertising and selling expenses of himself and his subagents. (30 B. T. A. 1131, at 1133.) (Underscoring added.)

In the article entitled: "When does a Seller of Real Estate Become a Dealer" in the 1950 University of Southern California Tax Institute (p. 325), Mr. Lucien W. Shaw, the author, discusses these cases and emphasizes that all Courts, including this Court, have never held a mere frequency and continuity of sales of properties acquired as capital assets by itself to be sufficient to convert such capital assets into assets held primarily for sale to customers in the ordinary course of business, where the sale of such assets is unaccompanied by any developmental or sales promotional activities.

There is no substantial basis for a contention that a taxpayer should be entitled to reap the business profit obtained in disposing of capital assets by means of a sale thereof only after extensive and intensive activities, to wit: subdividing, intensive and extensive advertising for

by the petitioners. The respondent there made exactly the same argument he is making in these cases. The Tax Court rendered a decision for the petitioners, holding that:

> "The facts here * * * also indicate that the sales in question appear to have been essentially in the nature of a gradual and passive liquidation without 'extensive development' and 'sales activity'. In the *Farley* case, in dealing with *Ehrman v. Commissioner*, supra, and *Richards v. Commissioner*, 81 Fed. (2d) 369 [17 AFTR 360], both cited by respondent, we said that where the liquidation of an estate is accompanied by extended development and sales activity the mere fact of liquidation will not be considered as precluding the existence of a trade or business. In the absence of these elements, however, we held that liquidation could not be disregarded, and hence in the *Farley* case we held that profits derived from sales were taxable as long term capital gains. Approval of the Tax Court's reasoning and result in the Farley case was expressed by the Fifth Circuit in their opinion in White v. Commissioner, 172 Fed. (2d) 629 [1949 P. H. Paragraph 72.346 (C.C.A. 5).]" (Underscoring added.)

The *Dagmar Gruy* case shows that the frequency and continuity of sales is not by itself sufficient to change the character of property built and rented, i.e., capital assets, into assets held primarily for sale to customers in the ordinary course of business and that merely selling capital assets is by itself insufficient to convert such assets into assets held primarily for sale in the ordinary course of business.

The late decision of *A. Benetti Novelty Co., Inc.,* 13 T.C. 1072 (Dec. 22, 1949) is an excellent illustration of the principle here asserted. There the petitioner acquired a large number of slot machines prior to the war for rental to its customers. During the war a wartime scarcity of slot machines arose. The demand became very great from the U. S. Armed Services for slot machines for service clubs. The petitioners was requested by the Army and Navy to obtain as many slot machines as possible. The petitioner bought up all the machines it could find in Nevada and the surrounding states. Instead of selling these new machines to the U. S. Armed Services, petitioner retained most of them for use in its business. It repaired and rehabilitated many of the machines it had rented. These repaired and rehabilitated machines it sold to the Armed Services and other purchasers during the taxable years 1943, 1944 and 1945. As to the machines bought for resale during this period and resold without having been rented, petitioner admitted the gain derived was ordinary income from the sale of property held primarily for sale to customers in the ordinary course of business. The issue before the Tax Court was whether the gain on the machines which had been rented and thereafter sold was taxable as capital gain or as ordinary income.

In the taxable years in question—1943, 1944 and 1945—petitioner sold 391 slot machines.

The Tax Court rejected Respondent's determination that said slot machines which had been rented and then sold were held primarily for sale to customers in the ordinary course of business. The Tax Court held for the petitioner, stating at 1078 that:

> "It thus seems that the gains in issue were derived from sales of machines which were originally purchased and held for rental purposes only." (Underscoring added.)

The Court reached this decision despite the fact that in the *A. Benetti Novelty Co., Inc.*, case (as was also true in the *Elgin Building Corporation* case ..... T.C. .....; Para. 49,015, P-H TC Memo. 1949 infra, at p. 45), the left hand of the taxpayer was engaged in the business of selling property held primarily for sale to customers in the ordinary course of business.

Since in these cases, Rollingwood sold only property which it acquired and built for rental and which it in fact rented for an average of 22.9 months per house, Rollingwood is in a position immeasurably stronger than that of petitioner in the *A. Benetti Novelty Co., Inc.*, case.

To the same effect is the decision of the United States Court of Appeals for the Fifth Circuit in *Fahs v. J. T. Crawford,* 161 F. 2d 315 (1947). In that case the taxpayers were held to have passively sold lots from an existing subdivision in a manner whereby they did no more than to receive the purchase price and execute the deeds. The Court held that a verdict was properly directed for the taxpayer, stating at page 317:

> "In essence, the taxpayer here has done no more than hold land purchased by him as an investment, qualify it for FHA loans so that it would sell, and accept the purchase price and execute deeds therefor as it was purchased or sold by Commander. This is not enough to put the taxpayer into the real estate business. It amounts to no more than converting a capital asset into cash." (Underscoring added.)

These cases should be contrasted with the converse situation—where property originally acquired as an investment is sold with substantial developmental and advertising activities, accompanied by the payment of real estate commissions, i.e., such as the subdivisions involved in *Richards v. Commissioner,* 81 F. 2d 369, and *Ehrman v. Commissioner,* 120 F. 2d 607. In either of these situations the capital gain treatment is not permitted the taxpayer because his business activities in the disposition of his properties are held to be sufficient to convert capital assets into assets held primarily for sale to customers in the ordinary course of business. In the case of *R. H. Hutchinson,* .....T.C....., Para. 49,155 P-H TC Memo. (1949), the taxpayer acquired an eight acre tract of land intending to use one-half for a factory site and to sell the rest in one transaction. He abandoned this purpose and subdivided the property. His sales of lots were accompanied by extensive advertising and sales activities. The Tax Court rejected the contention of the taxpayer that he was passively liquidating property and held that his activities in the disposition of this property prevented the application of the clearly established doctrine that where a taxpayer passively liquidates capital assets, his sales of property will not be held to be sales in the ordinary course of business of property held primarily for sale to customers.

The exception from the capital gain treatment of the sales of property held primarily for sale to customers in the ordinary course of business is applicable to property which a merchant holds for sale to the public and which a dealer holds for sale to his customers. Because of the

increment in profit and the different financial result due to the "business" manner in which the sales are conducted, their income is treated like income from personal services, rents and the like. But in the absence of any business activities and consequently in the absence of the business profits attributable to such activities, the capital asset treatment should not be denied a taxpayer merely because it sells itself out of the business of renting homes.

E. Cases relied on by the Tax Court which hold that assets built and acquired primarily for sale are not converted into capital assets by the mere rental thereof are not in point in this case because these houses were built and acquired for rental.

The Tax Court relied on *Neils Schultz,* 44 B.T.A. 146, *Charles H. Black Sr.,* 45 B.T.A. 204 and *Walter G. Morley,* 8 T.C. 904, for the proposition that the rental of these houses did not preclude them from being considered houses held primarily for sale to customers in the ordinary course of business.

In all of those cases, however, the properties involved were expressly found to have been built for sale, and the holding was only that incidental rental of these properties would not convert them into capital assets.

In the cases before this Court, the facts conclusively show that the houses involved were built, not primarily for sale to customers in the ordinary course of business, but for rental and thus the cases relied upon by the Tax Court are not in point.

Rollingwood Corporation *built* these houses for rental. It placed the possession, use and control of each and every house beyond its power for a period of thirty months.

When Rollingwood sold these houses it passively liquidated capital assets and itself went into liquidation shortly thereafter.

VI. ON FACTS FAR LESS FAVORABLE TO THE TAXPAYER THAN THOSE NOW BEFORE THIS COURT, THE TAX COURT DECIDED THAT HOUSES WERE NOT HELD PRIMARILY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF BUSINESS.

Under strikingly similar facts, but facts which were less favorable to the taxpayers than those now before this Court, the Tax Court itself reached the conclusion that houses so built and rented, should not be considered as property held primarily for sale to customers in the ordinary course of business. *Elgin Building Corporation* (1949) ..... T.C. ....., Para. 49,015 P-H TC Memo. 1949. Uniformity of taxation among taxpayers of the same general class under almost identical facts has absolutely no meaning, if the Elgin taxpayers are to be treated by the Tax Court in one way and Rollingwood in another.

The alleged deficiency which the Commissioner of Internal Revenue has asserted against Rollingwood Corporation was determined by the Commissioner in 1948, and *prior to the decision in the Elgin case,* which was rendered by the Tax Court on February 15, 1949.

We submit that the facts in the cases now before this Court are not capable of distinction from the facts in the *Elgin* case, and we will await with interest such attempts as Respondent may make to suggest any grounds of distinction.

In the *Elgin* case and in the cases now before this Court:

1. There was an acute housing shortage in critical war production areas. (Stipulation, Paragraphs 8 and 9, R. 24, 25.)

2. The policy of the United States Government (Federal Housing Administration) was communicated or known to the taxpayers, i.e., the policy of encouraging the construction of defense houses for rental purposes "to provide rental housing for defense workers so that they would not have to buy a house in order to stay on the job." (This quotation and all other quotations in this enumeration are, unless otherwise noted, from the opinion of the Tax Court in the *Elgin* case.) (Stipulation, paragraph 13, R. 26, 27.)

3. The taxpayers were requested to undertake their projects either by officials of the United States Government or critical war industry. (Stipulation, Paragraph 10, R. 25.)

4. Three separate corporations were formed by the sponsors of the Elgin projects, and Mr. Bohannon sponsored Rollingwood, the only corporation here involved, and three other corporations which are not involved in these cases. All corporations herein referred to were organized with a view to projects under Title VI of the National Housing Act. (Stipulation, Paragraphs 13, 35, 37, 38, R. 26, 40, 41, 42.)

5. Title VI of the National Housing Act, as stated in the *Elgin* case, "contemplated increasing the availability of rental properties * * *" which is stipulated to have

been true in these cases. (Stipulation, Paragraph 13, R. 26, 27.)

6. In *Elgin,* the sponsors or their affiliates advanced funds to their corporations. In the cases now before this Court Mr. Bohannon and one of his associates executed to Bank of America National Trust & Savings Association a continuing guarantee, guaranteeing loans to Rollingwood in the aggregate amount of $4,000,000.00 under which the guarantors were liable for 700 Federal Housing Administration Loans and $600,000.00 of open credit extended to Rollingwood. (Stipulation, Paragraphs 26 and 27, and Exhibit 10, R. 36, 37.)

7. The financing through the Federal Housing Administration, the supervision thereby of the building sites and of the plans and specifications and of the insurance of loans by the Federal Housing Administration were the same in the *Elgin* case as here. (Stipulation, Paragraphs 13, 26 and 27, R. 26, 36, 37.)

8. The applications to the War Production Board for priorities imposed substantially the same conditions upon and exacted substantially the same agreements both in the *Elgin* case and in the cases now before this Court. (Stipulation, Paragraphs 15 and 17, and Exhibits 1, 2, 3 and 4, R. 28, 29.)

9. The same General Orders of the National Housing Agency were applicable, and in neither the *Elgin* case nor in the cases now before this Court were any applications made to the Government for permission to sell. (Stipulation, Paragraph 29, Exhibits 12, 13, 14 and 15, R. 38.)

10. In the *Elgin* case 235 houses were built by the corporations there involved. Rollingwood built 700.

11. In the *Elgin* case "many of the houses were sold by the corporations either to tenants who occupied the houses or to non-tenants when the houses were vacant." All sales by Rollingwood were so made. (Stipulation, Paragraph 28, R. 37, Exhibit 11.)

12. No "For Sale" signs were ever displayed on the *Elgin* houses. No "For Sale" signs were ever displayed on either the Rollingwood houses or on the Rollingwood tract. (Stipulation, Paragraph 25, R. 35, 36.)

Not only do the *Elgin* case and the case now before this Court involve strikingly similar facts, but in addition the facts now before this Court are much stronger in favor of the petitioners in these respects:

1. In the *Elgin* case "most of the houses were sold by real estate brokers," whereas Rollingwood did not sell a single house through a real estate broker. (Stipulation, Paragraph 25, R. 35, 36.)

2. In the *Elgin* case (based upon the schedules set forth in the Tax Court's decision) more than 27% of the houses were sold without ever having been rented, whereas

Rollingwood immediately rented every house constructed by it under an agreement that committed Rollingwood to the rental of every house for 30 months. (Stipulation, Paragraph 22, R. 32, 33.)

3. In the *Elgin* case (based only upon the houses actually rented as shown by the schedules set forth

in the Tax Court's decision) the average period of rental per house rented was 15.39 months, whereas

The average period of rental of Rollingwood's houses was 22.9 months per house. (Computation based on Stipulation, Paragraph 28, Exhibit 11, R. 37, 38.)

4. In the *Elgin* case there was no evidence of any advertisement "For Rent" whereas

In the cases now before this Court Rollingwood, prior to completion of its houses published the advertisement "For Rent," of which a photostatic copy is included in the Stipulation of Facts and in this Brief, and during the entire period of construction and until all of its houses were rented and beyond its control for a period of 30 months Rollingwood maintained signs on its tracts stating that said houses were "For Rent" for $50.00 per month. (Stipulation, Paragraphs 23, 24, and 25, Exhibit 9, R. 34, 35, 36, 52.)

In the *Elgin* case that portion of the houses that were sold without ever having been rented at all were properly determined to have been property held by the Elgin taxpayers primarily for sale to their customers in the ordinary course of their business. From this it necessarily follows that the Elgin taxpayers were in the business of building houses primarily for sale to their customers in the ordinary course of their business. Yet, notwithstanding the existence of such business in the left hand of the Elgin taxpayers, the Tax Court felt compelled to hold, and did hold that the right hand of the Elgin taxpayers—with

respect to all houses that had once been rented—was disposing of properties not held primarily for sale to their customers in the ordinary course of their business.

This demonstrates, we submit, the unanswerable fact that the position of the taxpayers now before this Court is immeasurably stronger than that of the Elgin taxpayers. Rollingwood rented every house and rented every house under an agreement that, when executed, placed the possession and use and control of every house beyond the power of Rollingwood for a period of 30 months.

The following quotation from the opinion in the *Elgin* case, we submit, disposes of the contention of the Commissioner and sets forth the Tax Court's interpretation of Section 117(j) which is equally applicable in the cases now before this Court:

> "Under petitioners' commitments, if a house was once rented, it could not be sold unless the tenant exercised his option to purchase or an outsider bought subject to the tenant's rights. As to all of those properties, we agree that this circumstance stamped their primary purpose as rental or income-producing housing; and that they were capital assets under Section 117(j)."

This case illustrates explicitly the principle that the mere frequency and continuity of sales of capital assets is not by itself sufficient to change properties from capital assets to assets held primarily for sale to customers in the ordinary course of business.

VII. CONCLUSION.

We respectfully submit that the decisions of the Tax Court entered in these cases, were erroneous, and we respectfully request that this Court reverse those decisions in accordance with the prayer of the Petitions For Review by this Court.

Dated, San Francisco, California,
February 12, 1951.

Respectfully submitted,
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GARRET MCENERNEY II,
JAMES SHAUGHNESSY,
Counsel for Petitioners.

(Appendix A Follows.)

Appendix A.

Appendix A

STATUTES AND REGULATIONS INVOLVED.

Internal Revenue Code Section 117 Capital Gains and Losses (As applicable to years 1943, 1944, 1945, 1946 and 1947).

"(a) *Definitions.*—As used in this chapter.

(1) *Capital Assets.*—The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property used in the trade or business of a character which is subject to the allowance for depreciation provided in Section 23 (1), or an obligation of the United States or any of its possessions, or of a State or Territory or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer."

. . . . . .

"(j) *Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*

(1) *Definition of Property Used in the Trade or Business.*—For the purposes of this subsection, the term 'property used in the trade or business' means

property used in the trade or business, of a character which is subject to the allowance for depreciation provided in Section 23 (l), held for more than six months, and real property used in the trade or business, held for more than six months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

(2) *General Rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion."

. . . . . .

Regulations 111 of the Bureau of Internal Revenue:

Section 29.117-7 (as amended by T. D. 5394, July 27, 1944)

"*Gains and Losses From Involuntary Conversions and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—Section 117(j) provides that the recognized gains and losses

(a) from the sale, exchange, or involuntary conversion of property used in the trade or business of the taxpayer at the time of the sale, exchange, or involuntary conversion, held for more than 6 months, which is

(1) of a character subject to the allowance for depreciation provided in Section 23 (1), or

(2) real property,

provided that such property is not of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or is not held by the taxpayer primarily for sale to customers in the ordinary course of trade or business, and . . ."

Nos. 12,728-12,729

In the United States Court of Appeals for the Ninth Circuit

ROLLINGWOOD CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

and

DAVID D. BOHANNON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The only previous opinion is the Tax Court's memorandum findings of fact and opinion entered July 17, 1950 (R. 70-78), which is not reported.

JURISDICTION

The petition for review of the taxpayer, Rollingwood Corporation (R. 91-94), involves deficiencies in federal income and excess profits taxes determined by the Commissioner against it for the fiscal years ended May 31, 1944, 1945, 1946 and 1947, in the aggregate sums of $41,960.54 and $8,486.28, respectively. On May 25, 1948, the Commissioner mailed the taxpayer a notice of deficiencies in such taxes in these amounts. (R. 10-12.) Within ninety days thereafter and on August 19, 1948, the taxpayer filed a petition with the Tax Court for a redetermination of such deficiencies under Section 272 (a) (1) of the Internal Revenue Code. (R. 3, 5-12.) The decision of the Tax Court that there are deficiencies in such taxes in the aggregate amounts aforesaid was entered July 17, 1950. (R. 79.) The proceeding is brought to this Court by petition for review filed October 9, 1950 (R. 91-94), under the provisions of Section 1141 (a) of the Code, as amended by Section 36 of the Act of June 25, 1948.

The petition for review of David D. Bohannon (R. 118-123) involves the deficiencies in the federal income and excess profits taxes of the taxpayer, Rollingwood Corporation, for the fiscal years and in the amounts aforesaid, of which he admits liability as transferee of the assets of that corporation for the tax deficiencies, if any, finally found to be due and owing from it by reason of the matters brought before the Tax Court by it in the proceeding above mentioned. On May 25, 1948, the Commissioner mailed to Bohannon a notice that he had determined deficiencies in such taxes for those years in the amounts stated and that the aggregate amount of such deficiencies, with interest as provided by law, constituted his liability as such transferee. (R. 109-110.) Within ninety days thereafter, and on August 19, 1948, Bohannon, as such transferee, filed a

petition with the Tax Court for a redetermination of such deficiencies under Section 272 (a) (1) of the Code, in which he likewise admitted his transferee liability if the corporation was finally held liable for such deficiencies. (R. 102, 104-108.) The decision of the Tax Court that the aggregate amount of such deficiencies was due from Bohannon as such transferee was entered July 17, 1950. (R. 115.) The proceeding is brought to this Court by petition for review filed October 9, 1950 (R. 118-123), also under the provisions of Section 1141 (a) of the Code, as amended by Section 36 of the Act of June 25, 1948.

Upon stipulation of the parties (R. 126-127), the motion of the taxpayer and its transferee, Bohannon, to consolidate the two proceedings for the purpose of review by this Court (R. 127-128) was granted by the Court (R. 129).

QUESTION PRESENTED

Whether there is evidence to sustain the Tax Court's finding that the 700 houses in question were held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business, within the meaning of Section 117 (j) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

These are set out in the Appendix, *infra*.

STATEMENT

As has already been stated, the two proceedings on review here were consolidated for trial and report by stipulation of the parties (R. 15-16) and were tried by the Tax Court upon a joint stipulation of facts (R. 18-43). Reference throughout this brief to the "taxpayer" is to the Rollingwood Corporation. As has also been stated, the transferee, David D. Bohannon, has throughout admitted his liability as such in the event

the deficiencies against the corporation are sustained. The Tax Court's findings are based wholly on the stipulation of facts (R. 71-75), and may be summarized as follows:

On October 3, 1942, Bohannon filed an F.H.A. application for priorities of building material for the construction of 400 houses for disposal to defense workers on what was known as the lease-option plan, pursuant to which each house was to be rented to a certified defense worker at $50 per month with a thirty months' option to purchase the home for $4,800. (R. 72.) On January 9, 1943, Bohannon and one Ross M. Chamberlain organized the taxpayer corporation with a capital stock of 50 shares of the par value of $100 per share. Bohannon received 26 of these shares and Chamberlain 24. (R. 72-73.) On January 14, 1943, Bohannon filed a similar application for the construction of 300 additional houses on the same plan. (R. 73.) Bohannon assigned the two applications to the taxpayer, which employed the construction firm of Bohannon and Chamberlain, of which Bohannon and Chamberlain were the only general partners, to construct the houses. The acquisition of the acreage upon which the houses were built and their construction were financed by bank loans made by the taxpayer which were partially guaranteed by the Federal Housing Administration as well as by Bohannon and Chamberlain personally, and partly by Bohannon and Chamberlain alone. (R. 73-74.) Upon the completion of the houses on August 14, 1943, all of them were rented to certified defense workers under lease-option agreements pursuant to the stated plan. (R. 74.) During the taxpayer's fiscal years ended May 31, 1944, to 1947, inclusive, the taxpayer sold all of the houses at a gross profit of $587,234.36 as follows (R. 75):

Fiscal Year Ending	No. of Houses Sold (1)	(2)	(3)	(4)	Gross Profit on Sales
May 31, 1944.....	32	4	28	0	$15,946.04
May 31, 1945.....	224	46	175	3	144,191.74
May 31, 1946.....	357	221	136	0	183,421.46
May 31, 1947.....	188	15	165	8	243,675.12
Totals.....	801	286	504	11	$587,234.36

(1) The total number of houses sold exceeds 700, the number constructed, because the petitioner reacquired 81 houses by repossession and 24 by repurchase. On May 31, 1947, it owned 4 of the houses.
(2) Number of houses sold under option.
(3) Number of houses sold to non-tenants.
(4) Number of houses sold to tenants who rerented without option to buy.

The Tax Court concluded that the houses were held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. (R. 75.)

SUMMARY OF ARGUMENT

The Tax Court found that the houses in question were held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business within the meaning of the capital gains provisions of the Internal Revenue Code. Such finding is sustained by the stipulated facts, taken together with the failures of proof and the inferences to be drawn therefrom. This is so regardless of whether, in the context of these provisions, the word "primarily" was used by Congress in the sense of "chief," or "principal," as the taxpayer contends, or in the sense of "fundamental" or "essential," as the Commissioner contends. However the use of the word in the sense of "fundamental" or "essential" is not only implicit in the decisions of this Court, but accords with the definition given it by the Supreme Court in the framework of a similar statute. It is besides consonant with the legislative purpose in enacting the capital gains provisions of the federal taxing statutes, as disclosed by their legislative history. Certain circumstances, upon which the taxpayer relies to sustain a conclusion contrary to that reached by the Tax Court, are merely a part of the

overall picture of the taxpayer's operations, which it ignores. The taxpayer's contention that it was not engaged in the business of selling at all, because its selling activities were not accompanied by any extended development and sales activities, proceeds upon the erroneous assumption that the houses were constructed solely for rental purposes. The contrary is the fact, and the extent of the taxpayer's sales activities speaks for itself. The Tax Court's decision in the *Elgin Building Corp.* case, which the taxpayer contends is controlling here, was regarded by the Tax Court itself as distinguishable on its facts. In any event, it is obviously not controlling here.

ARGUMENT

There Is Ample Evidence to Sustain the Tax Court's Finding That the 700 Houses in Question Were Held by the Taxpayer Primarily for Sale to Customers in the Ordinary Course of Its Trade or Business in the Taxable Years Here in Question, Within the Meaning of Section 117 (j) of the Internal Revenue Code

A. *To sustain the Tax Court's decision on the facts of this case, it is immaterial how the word "primarily" is defined in the context of Section 117*

The taxpayer's contention that it did not hold the houses here in question primarily for sale to customers in the ordinary course of its business is predicated on the assumption that the word "primarily" was used by Congress in the context of the capital gains provisions of the Internal Revenue Code, and in the cognate provisions in the prior revenue laws, as meaning "first," or "chief," or "principal." On this assumption, the taxpayer asks this Court to draw a conclusion from the stipulated facts, contrary to that drawn therefrom by the Tax Court, that it held the property "primarily" for rent and not "primarily" for sale, within

the meaning of Section 117 (j) (1) of the Internal Revenue Code, Appendix, *infra*.

On the other hand, the Commissioner contends that the word "primarily" as used in the capital gains provision of the federal taxing statutes, connotes "fundamental" or "essential" and that, whether the taxpayer's sales activities were such, depends entirely upon their nature and extent; that is, upon whether they were substantial, regardless of the nature and extent of the taxpayer's rental activities.

But, while we shall undertake to demonstrate that this is the definition of "primarily" which is implicit in the decisions of this Court involving the application of the exception here in question, as also the definition given the word by the Supreme Court in a similar statute, and further that such definition implements the purpose of Congress in enacting it, as is disclosed by the legislative history of the capital gains provisions of the federal revenue laws, still, on the facts here, the decision of the Tax Court is not only correct, but, as we believe, the only possible one, even under the taxpayer's interpretation of the statute.

B. *Under the decisions of this Court, the question whether property is primarily held by the taxpayer for sale in the ordinary course of a business is regarded as depending solely on the nature and extent of his sales activities*

This Court has consistently held that whether property is held by the taxpayer primarily for sale within the meaning of the capital gains provisions of the revenue laws is essentially one of fact. (*Richards* v. *Commissioner,* 81 F. 2d 369, 370; *Field* v. *Commissioner,* 180 F. 2d 170; *Rubino* v. *Commissioner,* decided January 2, 1951 (1951 C.C.H., par. 9124)), and that the answer thereto revolves largely around the frequency

and continuity of the transactions claimed to result in a trade or business. (*Richards* v. *Commissioner, supra,* p. 273; *Commissioner* v. *Boeing,* 106 F. 2d 305, 309, certiorari denied, 308 U. S. 619; *Ehrman* v. *Commissioner,* 120 F. 2d 607, 610; *Field* v. *Commissioner, supra*). Thus, in the *Field* case, the Court affirmed the decision of the Tax Court upon the Tax Court's memorandum opinion of February 23, 1949 (1949 P-H T.C. Memorandum Decisions, par. 49,043), wherein the Tax Court had pointed out that, in both the *Richards* and *Ehrman* cases, this Court had rejected the taxpayers' reasons for purchasing the properties because of little significance, if the sales were so extensive as to establish them in the business of selling real estate on their own account. In this connection, it is to be observed that not only in the *Richards* and *Ehrman* cases, pp. 370 and 610, respectively, but also in the *Boeing* case, p. 309, as well, this Court also rejected the liquidation test in determining whether or not the taxpayer was carrying on a trade or business within the meaning of the capital gains provisions of the statute. But cf. *Delsing* v. *Commissioner* (C.A. 5th), decided January 5, 1951 (1951 C.C.H., par. 9125).

It is, of course, not necessary that such activity constitute the taxpayer's sole occupation or business, or that it occupy a majority of his time, and it may or may not be related to some other business activity of the taxpayer. *Harvey* v. *Commissioner*, 171 F. 2d 952 (C.A. 9th). See also *Snell* v. *Commissioner,* 97 F. 2d 891 (C.A. 5th).

Thus, while, in applying these provisions to the different situations which were presented in the various cases decided by it, this Court appears never actually to have defined the word "primarily" as therein used, nevertheless, its holdings in these cases are unquestionably predicated on the view that the nature and ex-

tent of the taxpayer's sales activities are in themselves determinative of whether the property was so held, and, by the same token, not upon a view ~~that~~ to their relative importance *vis-a-vis* some other business activity in which he was also engaged.

Of course, in the case at bar, both the taxpayer's renting and selling activities involved the same houses, and they may therefore be regarded as a single business activity. If so, the fact that each was substantial would obviously justify a finding under the decisions of this Court, already referred to, that the houses were held primarily for both rent and sale. But the situation would be no different, we submit, if each of these activities is regarded as a separate one, or independent of the other. In such event, too, the principle of these cases is applicable that the test of whether or not the houses were held primarily in connection with either one of these activities likewise depends upon the nature and extent thereof.

C. *The Supreme Court has defined the word "principal" to mean "fundamental," "essential," and hence "substantial" in a similar situation where it regarded it necessary to do so in order to implement the purpose of the statute*

In the case of *Board of Governors* v. *Agnew,* 329 U. S. 441, the Supreme Court recognized the fact that Congress had used the word "primarily" in different statutes with different connotations, depending upon the purpose of the particular statute. Thus, in that case, the Court said that, while one of the meanings of the word "primarily" when applied to a single subject is "first," "chief," or "principal," in the context of the provisions of the statute there under consideration, it meant "essentially," "fundamentally," and thus "substantial."

The provisions there in question were those of Section 32 of the Banking Act of 1933, c. 89, 48 Stat. 162, as amended, which prohibited, *inter alia,* any member of a partnership "primarily engaged" in the underwriting business from serving at the same time as an officer, director, or employee of a member bank of the Federal Reserve System. The purpose of the provision was to prevent such officer, director or employee from inducing the bank to purchase securities which his firm was underwriting. The respondents in that case were directors of the Paterson National Bank which was a member of the Federal Reserve System and were also partners of the brokerage firm of Eastman, Dillon & Company, whose underwriting business constituted less than 50 percent of its other business. The Court of Appeals for the District of Columbia (153 F. 2d 785) had construed the word "primarily" to mean "first," "chief," or "principal" in the context of the statute, and accordingly had held that the firm was not "primarily engaged" in underwriting, because its underwriting activities did not by any quantitative test exceed 50 percent of its total business. The Supreme Court, however, said that it took a different view. It held that, in the context of Section 32, and in order to implement the stated legislative purpose thereof, the word "primarily" must be read as referring to a function or activity which was "essential" or "fundamental," and hence to one which was "substantial," so that, if the firm's underwriting business was substantial, it was engaged therein in a "primary" way, even though by any quantitative test underwriting may not have been its chief or principal activity.

We do not argue that the decision of the Supreme Court in this case is necessarily controlling of the meaning of the word "primarily" as used in the capital gains provisions of the federal taxing statutes. We

do say, however, that the Supreme Court made it clear therein that the meaning of the words in a given statute depends entirely upon the purpose which Congress intended to subserve in enacting it. Thus, as we shall undertake to show under our next subpoint (D), in the case of the capital gains provisions, their legislative history clearly discloses a continuing Congressional purpose sharply to distinguish taxwise between business gains and profits from the sale of property and those which are not such. And, in order adequately to implement that purpose, Congress must of necessity—as is indeed suggested, or at least inferable from, the decisions of this Court, above referred to—be deemed to have used the word "primarily" in the same sense that it used it in Section 32 of the Banking Act of 1933, namely, in the sense of "fundamentally" or "essentially."

D. *The legislative history of the capital gains provisions discloses a continuing Congressional purpose sharply to distinguish taxwise between property held for sale in the ordinary course of a trade or business and that which was not so held*

When Congress first evolved the idea in 1921 of taxing gain from the sale of "capital assets" at different rates from business gains and profits, it defined the term "capital assets" by Section 206 of the Revenue Act of 1921, c. 136, 42 Stat. 227, as including all property, with certain stated exceptions, namely (1) that held for the personal use or consumption of the taxpayer or his family; (2) stock in trade of the taxpayer; and (3) other property of a kind which would properly be included in inventory of the taxpayer if on hand at the close of the taxable year. The reason given for not taxing property not held for sale in the ordinary course of a business, such as stock in trade and that includible

in inventories, at ordinary rates was that the sale of capital assets, such as farms, mineral properties, and other similar property—that is, property that was used in connection with a business as distinguished from that held for sale therein—was then severely retarded by the fact that gains and profits earned over a series of years, as a result of holding such property, were under then existing provisions of law taxed as a lump sum, with the result that desirable sales thereof were delayed. See H. Rep. No. 350, 67th Cong., 1st Sess., p. 10 (1939-1 Cum. Bull. (Part 2) 168, 176); S. Rep. No. 275, 67th Cong., 1st Sess., pp. 12-13 (1939-1 Cum. Bull. (Part 2) 181, 89).

The first amendments of these provisions were made by Section 208 of the Revenue Act of 1924, c. 234, 43 Stat. 253. These were two in number, namely, (1) the exception relating to property held for personal use was dropped, with which we are not, however, concerned here, and, (2) there was added the exception of "property held by the taxpayer *primarily* for sale in the course of his trade or business." The italics are supplied for emphasis since it is here that the word "primarily" first appeared in these provisions. It is therefore of the utmost importance that the reasons therefor be understood. Both the House and Senate committee reports explained that the sole reason for the addition of this exception was a purpose "to remove any doubt as to whether property which is held primarily for resale constitutes a capital asset, whether or not it is the type of property which under good accounting practice would be included in the inventory." See H. Rep. No. 179, 68th Cong., 1st Sess., p. 19 (1939-1 Cum. Bull. (Part 2) 241, 255), and S. Rep. No. 398, 68th Cong., 1st Sess., p. 22 (1939-1 Cum. Bull. (Part 2) 266, 281). In other words, the sole reason for making this change was to insure that *all*

property held for sale in the course of a trade or business be excepted from the definition of "capital assets," so that the gain from the sale of all property so held did not escape the imposition of the normal tax.

The next change requiring explanation here occurred in 1934 when the words "held by the taxpayer primarily for sale in the course of his trade or business," used in the 1924 Act, were changed by Section 117 of the Revenue Act of 1934, c. 277, 48 Stat. 640, so as to read "held by the taxpayer primarily for sale *to customers* in the *ordinary* course of his trade or business." The italics are supplied to indicate the added words. The sole purpose of this change was to make it impossible longer to contend, as it had been, that a stock speculator trading on his own account was not subject to the provisions of Section 117. See S. Rep. No. 558, 73d Cong., 2d Sess., p. 12 (1939-1 Cum. Bull. (Part 2) 586, 595), and particularly H. (Conference) Rep. No. 1385, 73d Cong., 2d Sess., p. 22, Amendment No. 66 (1939-1 Cum. Bull. (Part 2) 627, 632).

The next important change in the provisions was made in Section 117 (a) (1) of the Revenue Act of 1938, c. 289, 52 Stat. 447, to which another exception was added, namely, "property, *used* in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l)." The italics are supplied in order to point up the fact that this section for the first time specifically distinguished between property *held* and property *used* in a trade or business; and it is important here to note that the exact language of this amendment was later used in Section 117 (j) (1), which was added to the Code by Section 151 of the Revenue Act of 1942, c. 619, 56 Stat. 798, and is here involved.

The exception added in Section 117 (a) (1) of the 1938 Act was made solely in order to permit those who

had suffered losses on a sale (or on a forced disposition) of property *used* in a trade or business, as distinguished from that *held* therein, to offset such losses against business gains. The reason given in justification of the amendment was that gains and losses from the sale or other disposition of property used by the taxpayer in his trade or business were in reality business gains and losses, no less than gains or losses from the sale of property held by him for sale in the ordinary course of his trade or business. See H. Rep. No. 1860, 75th Cong., 3d Sess., pp. 17, 34 (1939-1 Cum. Bull. (Part 2) 728, 732-733, 752); and S. Rep. No. 1567, 75th Cong., 3d Sess., p. 7 (1939-1 Cum. Bull. (Part 2) 779, 783).

By 1942, however, Congress had become concerned with also relieving the taxpayer who had made gains on the sale of such property, i. e. property *used* in connection with the taxpayer's trade or business. It was this concern which caused Congress to enact Section 117 (j) and thereby to relieve the taxpayer from the burden of the ordinary tax on gains derived from the sale of such property, unless the property was includible in his inventory, or was held by him "primarily" for sale in the ordinary course of his trade or business. At the same time, however, Congress wished to preserve the taxpayer's right to deduct his losses on such sales as ordinary losses. The device which it adopted to accomplish both results was to require the offsetting of such gains and losses against each other and to provide for the taxation of the gains, if they exceeded losses, at capital gain rates and the deduction of the losses from ordinary income, if these exceeded the gains. See H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 53-54 (1942-2 Cum. Bull. 372, 415); and S. Rep. No. 1631, 77th Cong., 2d Sess., p. 50 (1942-2 Cum. Bull. 504, 545).

We therefore submit that, during the entire period of some thirty years in which the capital gains provisions have been in effect, the primary purpose of Congress in making the various exceptions, as well as the changes therein, was to insure that gain from the sale of property held for sale—and for nearly fifteen years also that used—in the course of the taxpayer's trade or business be taxed at ordinary rates, and that only such property as was not so held or so used (except as provided in Section 117 (j) with regard to the gain from the sale of property so used), be accorded the preferential capital gain and loss treatment. It follows that there is nothing inconsistent with the *use* of property for rent and at the same time holding it for sale. This is made clear by the terms of the statute itself; for it provides that certain property used by the taxpayer in a trade or business shall be treated as a capital asset, but only such property "which is not" held primarily for sale. Thus, we submit, it is clear that the word "primarily," as used in this statute, does not mean first in point of time; if the underlying purpose of the building of the houses was their sale, then they were held "primarily" for sale. Indeed, we go further and say that, even though the chief purpose was rental, if the sale of the houses was also a substantial purpose, they still were held "primarily" for sale.

E. *The facts as stipulated, the failures of proof, and the inferences to be drawn therefrom sustain the Tax Court's finding in any view that may be taken of the statute*

It seems to us that, to sustain the Tax Court's finding in any view which may be taken of the statute, it is necessary only to review the facts as stipulated, in the light of the taxpayer's obvious failure of proof in re-

spect of certain important matters, and the reasonable inferences which are to be drawn therefrom.

However, before turning to a discussion of the facts, we desire to point out that the procedural question which the taxpayer raises as to the scope of review of a finding of the Tax Court based on stipulated facts (Br. 16-24), serves only to confuse the issue. In every case, the question on review of a fact finding of the Tax Court under the statute is whether its findings are or are not "clearly erroneous," and this, of necessity, depends upon whether the evidence, with proper inferences to be drawn therefrom, sustains the findings. It can make no real difference, in arriving at a conclusion that it does or does not, whether the appellate court, in final analysis, tests the Tax Court's findings directly by the stipulated facts, or whether it puts them aside until it has made its own findings and then compares those of the Tax Court therewith.

In either case, the rule is applicable that there can be no reversal of the Tax Court's fact findings, unless they are found to be clearly erroneous. The rational basis of the rule is not merely that the trier of the fact sees and hears the witnesses and is therefore best able to evaluate the credibility of their testimony, but also that a trial is to be had before the constituted trier of the facts, and that no party is entitled to another trial, on appeal, simply because the appellate court might, if it had itself been the trier of the facts, have reached a different conclusion on the evidence. Moreover, as a practical matter, in every case where the findings of the Tax Court are assailed on review, it becomes necessary for the appellate court to examine the evidence in order to determine whether such findings are justified thereby. It can, therefore, make little difference, as we have said, how the appellate court approaches the problem;

for, no matter how the case was tried below, in every non-jury case, the sole question on review of fact findings is whether they are supported by the facts as they were presented to the trier of the facts, with reasonable inferences to be drawn therefrom. Moreover, on appeal, such inferences should be those which are to be drawn from the evidence most favorable to the appellant or petitioner. We turn then to a consideration of the facts.

Prior to Pearl Harbor, that is, prior to December 7, 1941, one David D. Bohannon had been engaged in California in the business of subdividing and selling real property on a substantial and extensive scale. He was also the sole stockholder of a corporation known as Suburban Builders, Inc., which was engaged in the business of general contractor in the construction of homes for sale during and after construction. (R. 39-40.) Prior to the incorporation of the taxpayer by Bohannon and one Ross H. Chamberlain, as hereinafter explained, they had organized two corporations to construct privately owned war housing projects, one on August 9, 1941, known as Pacific Homes, Inc., and the other on June 10, 1942, known as Western Homes, Inc. The former constructed in all 341 houses and the other 559. Moreover, subsequent to the incorporation of the taxpayer, they organized the Greenwood Corporation, which constructed and rented 1,329 houses of which it sold 629 in its fiscal year ended June 3, 1945, and 449 in its fiscal year ended June 30, 1946. (R. 40-42.)

In order to obtain the necessary building material to construct the 700 houses in question, Bohannon made an F.H.A. application to build 400 houses for disposition to defense workers on what was known as the "rent-option plan." The plan provided for the rental of each house to such workers at $50 per month, coupled

with a thirty months' option given to the tenant to purchase the home for $4,800. Later in the same year, Bohannon made another similar application in order to obtain material for the building of 300 additional houses to be disposed of under the same type of plan. Bohannon assigned these applications to the taxpayer corporation, which he and one Chamberlain, who was Bohannon's associate in the construction business, had formed. The ground upon which the houses were to be built was purchased by the taxpayer, which then employed the construction firm of Bohannon and Chamberlain, of which they were the only general partners, to build the houses. The taxpayer had a capital of only $5,000, divided into 100 shares, of which 26 were issued to Bohannon and 24 to Chamberlain. The building of the houses was financed by loans made by the taxpayer which were partly guaranteed by the Federal Housing Administration, as also by Bohannon and Chamberlain personally, and partly by Bohannon and Chamberlain alone. Schedule L of Exhibit 18,[1] which is the taxpayer's income and declared excess profits tax return for the fiscal year ended May 31, 1944, shows that, in that fiscal year, the F.H.A. loans payable (which presumably refers to all of the loans made by the taxpayer), amounted to $3,090,000.

Immediately upon the completion of the project in August, 1943, the taxpayer rented all of the houses to certified defense workers with the option to purchase and commenced to sell the houses to them under the option in its fiscal year ended May 31, 1944. It continued to sell the houses thereafter, some under the options and some not, until all but four of them had been sold by the end of its fiscal year ended May 31, 1947. In all, the taxpayer thus sold 801 houses. This

[1] All of the exhibits referred to herein are exhibits attached to the stipulation of facts.

happened because it had reacquired 105 of them during this period, either by repossession or repurchase. (R. 74-75.)

The sales were made at a total gross profit of $587,-234.36. (R. 75.).[2] Exhibit 16 shows that the net profits from the sales for each of the taxable years ended May 31, 1944, 1945, 1946, and 1947 were in the amounts of $13,962.82, $68,899.22, $153,604.64, and $306,857.31, respectively. Schedule C of Exhibit 18 shows that the expenses of sale of 32 houses sold in the fiscal year ended May 31, 1944, were $344.17. Schedule C of Exhibit 22 shows that the expenses of sale of the 225 houses sold in the fiscal year ended May 31, 1945, were $52,293.02; Schedule C of Exhibit 24, that the miscellaneous expenses incidental to the sale of the 357 houses sold in the fiscal year ended May 31, 1946, were $320,-085.81, and that the commissions paid on those sales aggregated $5,075; and Schedule C of Exhibit 26, that the commissions paid in connection with the sale of the 188 houses made in the fiscal year ended May 31, 1947, amounted to $57,755.48 and the miscellaneous expenses incidental thereto to an additional sum of $35,020.39.

By way of contrast with the profits on the sales of the houses, Exhibit 16 shows the income, or loss, from the rental operations for the same fiscal years, but before allocation of administrative expenses thereto, to have been as follows: Income of $22,598.51 for the fiscal year ended May 31, 1944; income of $45,085.26 for the fiscal year ended May 31, 1945; a loss of $47,-605.91 for the fiscal year ended May 31, 1946, and a loss of $50,422.30 for the fiscal year ended May 31, 1947.

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[2] This amount does not include the sum of $65,456.15, profit taken up in the fiscal year ended May 31, 1947, on installment sales of prior years. Nor does it appear to include the amount of installment sales collected by Bohannon after the corporation was dissolved on May 31, 1947, and its assets distributed to him. (See Schedule C, Ex. 26.)

That is to say, the taxpayer's rental operations showed an over-all loss of $30,344.44 during the period of its existence.

Moreover, most of the sales were installment sales. It seems fairly clear, therefore, as has already been indicated (fn. 2, *supra*), that only a portion of the profits was taken into income by the taxpayer in each of its taxable years; for the corporation was dissolved on May 31, 1947, and its assets, valued at $130,000, were distributed to Bohannon, then its sole stockholder. These assets undoubtedly included not only the four unsold houses, but also the unpaid portions of installment contracts.

Also, not only by way of contrast with the expenses of sales, but by way of comparison with the gain from the rental operations themselves, the cost of the latter was enormous and out of all proportion to any possible gain therefrom. Thus Schedule B of Exhibit 18 shows that the cost of the rental operations for the taxpayer's first fiscal year during which only 32 houses were sold, ended May 31, 1944, and in which the gross rental profits were only $22,585.97 (Ex. 18, p. 1), was $321,-167.57, which included $111,206.79 interest on the loans; $66,480.10 as a charge for depreciation; $31,801.80 for maintenance and repairs; $19,879.42 for salaries; $10,-824.59 for F.H.A. insurance; $8,938.61 for fire and war damage insurance; $6,076.77 for automobile expenses and travel allowances; $4,442.97 for advertising, and other minor expenses. While the rental expenses were progressively reduced from year to year as the houses were sold, their scale remained such as to show that they would have continued to remain out of all proportion to any profits which could conceivably have been made had no sales been made and the project been continued as a rental one. Thus, a sheet attached to Exhibit 22 shows that the cost of the rental operations was

$293,598.61 for the fiscal year ended May 31, 1945, as against gross receipts by way of rental income of $337,624.03; a sheet attached to Exhibit 24 shows that the cost of rental operations for the fiscal year ended May 31, 1946, was $198,160.56, as against gross receipts by way of rental income of $145,058.48; and a sheet attached to Exhibit 26 shows that the cost of rental operations for the fiscal year ended May 31, 1947, was $68,098.79, as against gross receipts by way of rental income of $12,368.62.

It should be remembered that Bohannon was the prime mover in the taxpayer's activities and had, as stated, for years been engaged in the business of building dwelling house projects and selling houses therein. The war made it impossible for him, and his associate, Chamberlain, to continue in that business unless they constructed F.H.A. housing projects, because they could not otherwise have obtained the necessary building material to do so. Thus, under the lease-option plan of Bohannon's F.H.A. applications, they were enabled to continue their building and sales operations, albeit under certain restrictions, which, however, obviously did not prove to be any obstacle thereto. On the contrary, these restrictions actually subserved their sales activities by providing ready purchasers for the houses. No doubt, both anticipated this. There is, of course, no evidence to dispute the obvious inference that they did. In any case, they used the taxpayer as a convenient vehicle for the sales end of their operations. Here, too, there is no evidence from either Bohannon or Chamberlain, or, for that matter, from anyone else, to contradict this likewise obvious inference. That neither of them, nor anyone else, was called to testify that their main purpose was not to sell the houses but to rent them, can be explained on no other theory than that their over-all objective was the making of profit on

the construction and sale of the houses, rather than on the rental thereof. It seems to us fatuous to contend that men who had for years been engaged in the building and sale of large housing projects, should organize a $5,000 corporation to borrow more than $3,000,000, largely on their own personal guarantee, to build houses "primarily" for rental purposes, using the word "primarily" in the taxpayer's sense of "chiefly." Obviously, the amount borrowed could not have been repaid out of the rents, or otherwise than by a sale of the houses. And, of course, if Congress intended to use the word "primarily" in the sense of "essential," as we think it did, it may be assumed the taxpayer would concede that the houses were held primarily for sale within the meaning of the statute. For the taxpayer's sales activities were not only substantial, in the sense that they were continuous and important, but they were massive in all but its first taxable year, and, what is more, they were all inclusive, so that ultimately they resulted in the very destruction of the taxpayer's rental business and in the dissolution of the taxpayer itself.

It is to be noted that 256 of the houses were sold by the taxpayer prior to June 1, 1945 (R. 75), that is, during the period of hostilities. This was more than one third of the 700 built. But, of those sold during that time, only 50 were sold to the original tenants under the lease-option agreements; 203 of them were sold to non-tenants, and 3 to new tenants who were not given options to purchase. Of course, the fact that the taxpayer was able to sell 206 of the houses to non-tenants, as well as to new tenants, meant that that number of the original tenants had vacated the houses during the period of hostilities. Moreover, during the entire period of the taxpayer's existence, only 286 of the houses were sold to the original tenants. We do not know how many of

these were repossessed, although we do know that 105 houses which had been sold were repossessed. In any event, the majority of the remaining houses, including those that had been repossessed, were sold to non-tenants; only 11 of them being sold to new tenants who, however, had not been given options to purchase. In other words, none but the original tenants appears ever to have been given a long term rental agreement, thus, leaving the taxpayer a freer hand to sell.

Of course, only the general course of these events could have been foreseen. But the obvious inference they suggest is that the taxpayer's basic purpose was not the renting of the houses, which it accommodated to the exigencies of a situation requiring their sale, but that it was the sale of the houses, which it accommodated to a situation requiring their rental. To put it another way, the picture is not of a rental project which was forced into liquidation by the course of events, but of a sales project in connection with which the renting of the houses constituted only a means to the end.

What we have already said suffices, we think, to answer the taxpayer's contention that the circumstances to which it particularly adverts require this Court to draw the conclusion, contrary to that drawn by the Tax Court, namely, that the houses were held by it chiefly for rent. These circumstances may be summarized as follows:

(1) the advertising of the houses for rent (Br. 24-25);

(2) the critical war situation which led the Government to invite the construction of defense housing with rental conditions imposed thereon (Br. 25-28); and

(3) the character of the taxpayer's activities, both with respect to the renting of the houses and their sale

(Br. 28-32). Suffice it here to say that the taxpayer's argument based on these circumstances ignores the essential facts and particularly the over-all picture of its operations of which they are a part.

The taxpayer's further contention (Br. 33-45) that it was not engaged in the business of selling at all, because its selling activities were not accompanied by any extended development or sales activities, is wholly without merit. Such as it is, the argument proceeds upon the obviously erroneous assumption that the construction of the houses was undertaken solely for rental purposes. The contrary is obviously the fact, and its sales activities speak for themselves.

As far as concerns the taxpayer's final contention (Br. 45-50), that the Tax Court's memorandum decision of February 15, 1949, in the case of *Elgin Building Corp.* v. *Commissioner* (1949 P-H T. C. Memorandum Decisions, par. 49,015), is on all fours with the case at bar and should be followed here, it should suffice to say that the Tax Court, in its opinion in the case at bar, pointed out that the cited case was the sole reliance of the taxpayer below, but was to be distinguished on its facts. In any event, however, the Tax Court's decision therein is not controlling here.

CONCLUSION

For the reasons stated, the Tax Court's decisions should be affirmed.

Respectfully submitted,

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MARCH, 1951.

APPENDIX

Internal Revenue Code:

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * *

(j) [as added by Sec. 151 (b) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and amended by Sec. 127 of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Gains and Losses from Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of Property Used in the Trade or Business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l) held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

(2) *General Rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of

capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

* * * * *

(26 U.S.C. 1946 ed., Sec. 117.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.117-7 [as amended by T. D. 5394, 1944 Cum. Bull. 274, 276]. *Gains and Losses from Involuntary Conversions and from the Sale or Exchange of Certain Property Used in the Trade or Business.*—Section 117 (j) provides that the recognized gains and losses

(a) from the sale, exchange, or involuntary conversion of property used in the trade or business of the taxpayer at the time of the sale, exchange, or involuntary conversion, held for more than six months, which is

(1) of a character subject to the allowance for depreciation provided in section 23 (l), or

(2) real property,

provided that such property is not of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of

the taxable year, or is not held by the taxpayer primarily for sale to customers in the ordinary course of trade or business, and

* * * * *

shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets.

* * * * *

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Nos. 12,728 and 12,729

IN THE

United States Court of Appeals

For the Ninth Circuit

ROLLINGWOOD CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DAVID D. BOHANNON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petitions for Review of Decisions of the Tax Court of the United States.

REPLY BRIEF FOR PETITIONERS.

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Statutes

Other Authorities

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Petitions for Review of Decisions of the Tax Court of the United States.

REPLY BRIEF FOR PETITIONERS.

All of the facts in these cases are stipulated.

On the facts, Respondent is in an impossible position; hence, his brief,—based upon many assumptions and inferences not possible within the record,—attempts to ignore determinative facts which Respondent has stipulated.

Petitioners' position requires only,—and of course Petitioners will receive,—a determination of the issues on the facts and only those inferences founded upon the facts.

The impact of World War II can not be ignored as Respondent has attempted to do. The issue in these cases is not what Rollingwood Corporation would have done if World War II had not occurred, but on the contrary the issue is what Rollingwood Corporation in fact did do because of World War II, the requirements of the United States Government for rental housing and the policies and requirements of the United States Government in connection therewith. In fact Rollingwood Corporation would probably never have existed but for World War II and the requirements of the United States Government for rental housing.

Likewise what Mr. Bohannon would have done but for the occurrence of World War II, what he did prior to World War II and what he did after World War II are not of any significance whatever. The Respondent has stipulated (Stip. ¶ 35; R. 40) that Mr. Bohannon shortly after Pearl Harbor disbanded his sales force and thereafter maintained no sales force; and thereafter engaged in no advertising and in no land development or sales programs and that during all times here involved Mr. Bohannan devoted substantially his entire time and attention to the war housing project of Rollingwood Corporation and other war housing projects.

If World War II had not occurred Rollingwood Corporation (if it be assumed that it would have been or-

ganized if the war had not occurred) or Mr. Bohannon: (a) might have built houses for sale rather than for rental; (b) might have been able to obtain materials for the construction of houses without having to obtain priorities from a War Production Board; (c) might have operated a business similar to Mr. Bohannon's prewar business without restrictions placed upon the sale of houses by the National Housing Agency or the War Production Board; (d) might have placed "For Sale" signs rather than "For Rent" signs on houses built for sale; (e) might have advertised houses for sale rather than for rent; and (f) might have sold houses rather than rented them in accordance with an announced and advertised intention and in conformity to the policies of the United States Government. But these are not the facts of these cases nor should inferences be drawn from what might have been.

On the contrary the facts, in addition to showing such change in Mr. Bohannon's business, also show:*

(1) Rollingwood's private War housing project was initiated by a most critical War industry and not by Rollingwood Corporation or Mr. Bohannon. (R. 24, 25, 26.)

(2) This project was undertaken and completed in accordance with the policies of the United States Government to encourage the construction of defense houses for rent. (R. 26, 27.)

*These facts speak for themselves, and show the total lack of similarity between the cases now before this Court and the facts of *Rubino v. Commissioner*, ... F. (2d) ..... Nos. 12,535-12,536 (decided January 2, 1951), 1951 P.H. Tax Service, Vol. 4, ¶72,225.

(3) The conditions imposed by the U. S. Government on the issuance of priorities and the agreements made by Rollingwood Corporation with the United States Government in connection with such priorities required the rental of said houses. (Exhibits 1 and 3.)

(4) Rollingwood Corporation displayed on the construction site of this project two large signs setting forth the rent of these houses as a rent of $50.00 per month. (R. 34, 35.)

(5) Rollingwood Corporation conspicuously advertised these houses "For Rent—$50.00 a month New 3-Bedroom Homes." (R. 35.)

(6) Rollingwood Corporation's rental expenses included $5,432.53 for advertising in the years 1944 and 1945. (Exhibit 16, Stip. ¶ 30, R. 39.)

(7) Rollingwood Corporation, in fact, immediately rented all of said houses. (R. 32-34.)

(8) Rollingwood Corporation not only committed itself in writing to a thirty months rental of each of said houses, but also by granting an exclusive option to purchase to each of its tenants, placed its power to sell each of said houses beyond its control for thirty months, except to one person, i.e., the tenant thereof. This then eliminated all of the other possible purchasers within the market to whom such houses might have been sold. (R. 32-34, 44, 45.)

(9) Rollingwood Corporation rented these houses for an average period of 22.9 months. (R. 32, 37, 38, Exhibit 11 and computations therefrom.)

(10) Rollingwood Corporation was a successful rental enterprise financially. (Exhibit 16, Stip. ¶ 30, R. 39.)

(11) Rollingwood Corporation never displayed any "For Sale" signs on any of said houses nor on the Rollingwood tract. (R. 35.)

(12) Rollingwood Corporation never had any sales force for the purpose of selling said houses. (R. 36.)

(13) Rollingwood Corporation, following the completion of the construction of its project, on August 14, 1943, never engaged in any developmental activity with respect to the Rollingwood tract or said project, and never subdivided, nor otherwise improved any of its properties. (R. 32, 35, 36.)

Not only has Respondent sought to have this Court ignore all of the foregoing facts and circumstances, but in addition and without any explanation Respondent has also represented to this Court that based upon Schedule C of each of the tax returns of Rollingwood Corporation, the expenses of the sale of houses by Rollingwood Corporation in the years 1944, 1945, 1946 and 1947 were, respectively, $344.17, $52,293.02, $320,085.81 and $57,755.48.

The facts and the only facts shown in the Record, are that these expenses consisted of credits allowed to purchasers on the purchase price of houses by reason of rent previously paid and so allowed in accordance with the lease-option agreements under which such houses were rented, and such necessary adjustments as were charged to the purchaser at the time of sale for insurance, taxes, interest, etc., and because of the transfer to the purchaser

of the F.H.A. reserve fund created by Rollingwood Corporation for taxes and insurance. Respondent's representation is untenable in the face of the note at the bottom of Schedule C of the 1945 return (a similar note appears at the bottom of Schedule C to the 1946 and 1947 returns) which reads as follows:

> "Consistent with the prior year taxpayer has reported as adjustment to the sale price miscellaneous items charged to purchaser of property at time of sale, i.e., insurance, taxes, interest, etc., and for allowances given purchaser for rentals paid by purchaser during occupancy under option to buy agreement and for F.H.A. reserve fund for taxes and insurance taken over by purchaser at time of sale."

Because the Record contains no facts to support Respondent's position, he then leaps to the conclusion that Rollingwood Corporation was unprofitable as a rental enterprise. Besides the doubtful relevancy of this alleged fact, Respondent's conclusion is too hastily drawn.

In the first taxable year of its existence (a period of approximately 9½ months), Rollingwood Corporation's gross rental income was $343,766.07, while its expenses were only $338,095.03. In this first year it realized a net profit of $5,671.04 after having deducted all other expenses of any kind or nature, including:

1. All interest payments on borrowed money, i.e., the sum of $111,206.79.
2. A depreciation expense amounting to $66,480.10. (Exhibit 16, Stip. ¶ 30, R. 39.)

In its second fiscal year, ended May 31, 1945, Rollingwood Corporation's gross rental income was $338,683.87

while its expenses declined to only $315,496.79. In this year it realized a net profit from rental activities of $23,187.08, after having deducted all other expenses of any kind or nature, including:

1. All interest payments on borrowed money, i.e., the sum of $111,704.89.

2. A depreciation expense amounting to $65,984.96. (Exhibit 16, Stip. ¶ 30, R. 39.)

To fairly appraise the investment value and profit potential of such an enterprise, it would be necessary to project these results over a substantial number of years. If, at the end of its second fiscal year ended May 31, 1945, and if it were assumed that the rental expenses of Rollingwood Corporation would remain as high as in 1945 (which would be highly improbable), and if its future were projected for 30 years on the basis of its 1945 experience (the useful life of these houses stipulated to have been built of good materials and to have provided permanent housing facilities would extend more than 30 years) then it would be reasonable to conclude that over such thirty-year period:

The gross income from rental operations would be	$10,160,516.10
The gross expenses of all kinds would be	9,464,903.70
The net profit would be	695,612.40
The reserve for depreciation would be	1,979,548.80

and Rollingwood Corporation (except for any forced disposition of its houses through the exercising of any ten-

ant's exclusive option to purchase) would still have been the owner of these houses.*

YET RESPONDENT ARGUES AND CONCLUDES THAT THE COST OF THIS RENTAL PROJECT WAS OUT OF ALL PROPORTION TO ANY POSSIBLE GAIN!

Very appropriate here are the remarks of Judge Johnson in the case of *Julia K. Robertson,* .....TC....., P-H TC Memo Par. 49234 (1949) (cited by Petitioners herein only for its reasoning rejecting a similar argument since it is a factually different case from this one) as follows:

> "All circumstances concerning the acquisition and use of these properties in the taxable years stamp them as rental or investment property and not property held primarily for sale.
>
> "Respondent's adverse conclusion is based largely upon assumptions and deductions. He contends: (a) since it appears that petitioner derived a larger percentage of profits from sales than from rentals 'it is not reasonable to assume' that he would borrow over a million dollars to receive a small rental income rather than a 'reaping of profits' from sales; (b) that petitioner, prior to 1943, having been profitably engaged in building houses for sale, except for the fact that he 'had no other alternative' would not have changed his business to that of rental; and (c) petitioner's 1946 resumption of building for sale indicates that in the taxable years he was holding the

*The foregoing computations are based on Exhibits 16 and 22. In Exhibit 16 the Expense item "Real estate taxes" was adjusted by a reduction of $4,968.60 shown as a "Correction of Estimate of Real Estate Taxes" on Exhibit 16, and as shown on the Amended Return, Exhibit 22.

property for sale, and cites Neils Schultz, 44 BTA 146, where the taxpayer, after renting the property for some years before selling it, was nevertheless found to have held the property primarily for sale. There, however, the sale involved property sold in the taxable years, and not subsequently. There also the Court found specifically that the taxpayer 'acquired the land to be held for sale to customers' and the evidence here justifies no such finding.

"It matters not whether petitioner, from necessity or from choice, changed his business in the taxable years from building houses for sale to building them for rent. The question is, did he make such change, and the evidence shows that he did. Many individuals in the war years changed the kind of business in which they were engaged. In some instances the ratio of profits were larger, and in others smaller, but as patriotic citizens they cooperated, regardless of results. A vast majority of them also, when the war ended, resumed the same business in which they had been theretofore engaged, as did the petitioner." (Emphasis added.)

Respondent has further confused and treated as comparable (a) Rollingwood Corporation's rental business as it existed during its second fiscal year and (b) Rollingwood Corporation's rental business as it existed after 221 of its tenants had forced it to dispose of 221 of its houses by each such tenant exercising his exclusive right to purchase the house in which he resided.

Rollingwood Corporation during its first two fiscal years was a large rental housing project, and a highly profitable one.

In its third fiscal year ended May 31, 1946 (this entire year being after V-E Day and 9½ months of it after V-J Day), 221 of Rollingwood Corporation's tenants forced the sale to them of 221 houses by each such tenant exercising the option to purchase the house in which he resided. (Stip. ¶ 28, R. 37 and 38, Exhibit 11 and computations therefrom.)

Rollingwood Corporation during its last two fiscal years was neither a large rental housing project nor a profitable one.

This post-war action of the tenants could not have been foreseen (only 7.1% of the options were exercised during the War), especially since tenants were in-migrant war workers. (Stip. ¶ 28, R. 37, 38, Exhibit 11 and computations therefrom.)

At the time these options were granted, in 1943, World War II was in a very critical condition. It is common knowledge that it was then generally believed the War would continue for many years.

It is obvious that so long as Rollingwood Corporation had a large number of houses to rent its gross rental income was gigantic and it was profitable. But when, due to conditions beyond its control, it ceased to be either a large or a profitable rental business, it was forced to sell itself out of the rental business, and to convert capital assets into cash.

Respondent's brief, concerned with vague generalities and not with the specific basic issue of these cases, in addition to its erroneous assumptions and inferences above and beyond the Record, concedes the specific propo-

sition, both of fact and of law, established in Petitioner's Brief that Rollingwood Corporation disposed of the capital assets involved in these cases (houses built for and devoted to rental purposes), under circumstances which in view of the decisions of the Tax Court and of this Court would not convert these capital assets into assets held primarily for sale to customers in the ordinary course of business, i.e., in the sale thereof by Rollingwood Corporation, it:

(a) never engaged in any activities to promote sales;

(b) never displayed any "For Sale" signs on any of the properties involved;

(c) never maintained any sales force for the purpose of selling said properties;

(d) never engaged in any developmental activities of any kind or nature after the rental thereof. (Stip. pars. 21, 25, R. 32, 35, 36.)

The decisions of this Court to which Respondent refers (*Richards v. Commissioner,* 81 F. (2d) 369, and *Ehrman v. Commissioner,* 120 F. (2d) 607), have no applicability here because they very properly dealt with situations entirely different from that here presented.

The law of taxation, involving all phases of economic activity, has not developed into the comprehensive body of law which it is today by such vague generalities. It has developed by the process of literally thousands of Court decisions establishing on which side of the line should fall cases involving facts similar in some respects to, but different in other respects from those of previous cases.

This case is not like the *Ehrman* and *Richards* decisions for all of the reasons set forth and upon all of the authority cited in Petitioners' Brief (pages 33-50). Respondent does not attempt to meet either the reasons or the authority there set forth.

His attempts to read the word "primarily" out of the Statute altogether are without merit. First to Respondent "primarily" means "essential." After taking this step, he jumps from "essential" to "substantial."

In the *Richards* case this Court was very careful to follow closely the language of Section 117 of the Code itself when it decided that the word "held" was a more inclusive term than the word "purchase," despite very strong Congressional history to the contrary, which appears in the opinion of that case at page 372 as follows:

> "It is apparent from this quotation that Congress considered or perhaps contemplated lowering the tax for those owners 'who sell property not primarily purchased for the purpose of resale.'"

This Court in these cases should, we believe, follow the statutory language upon which these cases are to be decided (as it did in the *Richards* case), and consequently should refuse to emasculate Section 117 by obliterating the word "primarily."

In the decisions of this Court and in the decision of the United States Court of Appeals for the Eighth Circuit, *Albright v. U. S.*, 173 F. (2d) 339 (1949), it is obvious that the courts have given the words "primarily for sale to customers in the ordinary course of business" their full meaning and not an emasculated one, which is in full

accord with the legislative history of this statute. Furthermore, a contention made by the Respondent similar to that which he is making in these cases was expressly rejected in *U. S. v. Bennett,* ..... F. (2d) ....., January 8, 1951, Prentice-Hall 1951 Federal Tax Service Volume 4, paragraph 72,227, wherein the Court held:

> "If the statute had been intended to mean what the collector contends for, the word 'primarily' would not have been in it. Since 'primarily' is in the statute, it seems clear to us that to hold, as the collector contends, that the main, the first, purpose of the keeping of these breeder cattle was for sale, does complete violence to the statute and to its purpose and intent." (Emphasis added.)

Property "held by the taxpayer primarily for sale in the course of his trade or business" has been excluded from the definition of capital assets since the Revenue Act of 1924 (C. 234, 43 Stat. 253, Section 208).

"Property held by the taxpayer primarily for sale in the course of his trade or business" by the 1924 Act, was excluded from the definition of capital assets in order to plug a loop hole in the Revenue Act of 1921 (Section 206, C. 136, 42 Stat. 227). Under the 1921 Act (which first established in this country the "capital gain" method of taxation not theretofore used in this country) property of a kind which would properly be included in the taxpayer's inventory was excluded from the definition of capital assets and there was doubt whether real property, when it constituted economically the "inventory" of a taxpayer, could properly be included in the term "inventory" from an accounting standpoint. The

intent of Congress in passing the 1924 Act was to make certain that "dealer" real estate, like the "inventory" of a retailer or manufacturer of goods, would be excluded from the capital gain method of taxation. H.R. No. 179, 68th Cong., 1st Sess., p. 19, 1939-1 Cum. Bull. (Part 2) 255, and S.R. No. 398, 68th Cong., 1st Sess., p. 22, 1939-1 Cum. Bull. (Part 2) 281. This doubt was well founded because in the *Keeney* case, 17 BTA 560, the Board held a real estate dealer not excluded from the capital asset method of taxation (under the 1921 Act) because real property should not properly be included in taxpayer's inventory.

The Revenue Acts of 1938 (C. 289, 52 Stat. 447) and 1942 (Section 151, C. 619, 56 Stat. 798) have absolutely nothing to do with the question before this Court. The 1938 Act, as a relief measure excluded business property subject to depreciation from the loss limitations (and as a corollary from the gain benefits) upon the sale of capital assets. Property held primarily for sale to customers in the ordinary course of business, however, was already excluded by the 1924 Act.

As a relief measure the 1942 Act restored the capital gain benefits to the sales of business property subject to depreciation, but substantially left intact the benefits derived from the removal of the capital loss limitations on the sale of such property established by the 1938 Act. Here again the 1942 Act had absolutely nothing to do with property held primarily for sale to customers in the ordinary course of business, i.e., "dealer" property, because this type of property was already, and since 1924 always has been, excluded from the capital gain or loss provisions of Section 117. Nothing in the legislative his-

tory of these Acts is to the contrary. Furthermore the effect of (a) the 1934 Act (Section 117, C. 277, 48 Stat. 640) wherein the "dealer" exception was changed to "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business"; (b) the relief measure of the 1938 Act; (c) the relief measure of the 1942 Act, and (d) the reduction of the capital gain "holding period" from 2 years in 1924 to a nominal 6 months period by the 1942 Act, constitute the real history of this period and, if anything, show an increasingly liberal attitude of Congress towards the capital gain method of taxation and a total absence of any intent to narrow the definition of capital assets.

Petitioners submit that they have met their burden of proof in these cases, and have conclusively established that these 700 houses were constructed and built for rental and never held primarily for sale to customers in the ordinary course of business. Petitioners submit that this Court should, upon two separate principles, either (a) independently review whether these houses were ever held primarily for sale to customers in the ordinary course of business within the meaning of Section 117 (j) as a matter of law based upon evidentiary facts which are without conflict, or (b) reach its own conclusions of fact without regard to the findings of fact of the Tax Court because all of the evidence in these cases has been stipulated in writing.

Respondent cites the *Richards* case, 81 F. (2d) 369, as being opposed to the first principle, but has ignored *Commissioner v. Boeing,* 106 F. (2d) 305, overruling the *Richards* case on this point. The United States Court of Ap-

peals for the Seventh Circuit also has held this issue to be one of law for the appellate court to determine. *Three States Lumber Company v. Commissioner*, 158 F. (2d) 61 (1946).

As opposed to the second principle, Respondent states, without any authority, that the question in these cases is whether there is evidence to sustain the finding of the Tax Court. The following Courts disagree with Respondent's statement:

This Court—

Equitable Life Assurance Society v. Irelan, 123 F. (2d) 462 (1941);

This Court—

Pacific Portland Cement Co. v. Food Machinery Corp., 178 F. (2d) 541 (1949);

The United States Court of Appeals for the Second Circuit—

Orvis v. Higgins, 180 F. (2d) 537 (1950), cert. denied 340 U.S. 810;

The United States Court of Appeals for the District of Columbia—

Dollar v. Land, 184 F. (2d) 245 (1950);

The United States Court of Appeals for the Seventh Circuit—

Wigginton v. Order of United Commercial Travelers, 126 F. (2d) 659 (1942), cert. denied 317 U.S. 636;

The United States Supreme Court—

United States v. United States Gypsum Co., 333 U.S. 364, at 394 (1948).

We also note Respondent's failure, along with that of Honorable Marion J. Harron, the judge who decided these cases on behalf of the Tax Court, to discover any ground of distinction between these cases and the *Elgin Building Corporation* case, ... TC ....., par. 49,015, P-H TC Memo (1949), stated in Petitioners' Brief to have been in twelve respects identical with the facts of these cases, in four respects weaker than the facts of these cases, and in no respects distinguishable.

Dated, San Francisco, California,
March 31, 1951.

Respectfully submitted,
JUSTIN M. JACOBS,
GARRET MCENERNEY II,
JAMES SHAUGHNESSY,
Counsel for Petitioners.

No. 12732

United States
Court of Appeals
for the Ninth Circuit.

HEE KEE CHUN, Administratrix of the Estate of CHUN CHIN, Deceased,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Appeal from the United States District Court, Territory of Hawaii.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

No. 12732

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS OF RECORD

For the Plaintiff:

HEE KEE CHUN,
Administratrix of the Estate of Chun Chin, Deceased.

W. Y. CHAR, ESQ.,
Bishop National Bank Branch Bldg.,
Honolulu, T. H.

For the Defendant:

UNITED STATES OF AMERICA,

UNITED STATES DISTRICT ATTORNEY,
District of Hawaii,
Federal Building,
Honolulu, T. H.

In the United States District Court in and for the District and Territory of Hawaii

Civil No. 905

HEE KEE CHUN, Administratrix of the Estate of Chun Chin, Deceased,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT

First Count

I.

The action, brought under Paragraph 20 of Section 24 of the Act of March 3, 1911, 36 Stat. 1093, as amended (U. S. C. Title 28, Sec. 41(20)) as amended, Title 28, U. S. C. (Investigation of 1948), Sec. 1346 (a) (2), is founded upon an express contract with the Government of the United States.

II.

The amount in controversy does not exceed the sum of $10,000.00.

III.

Plaintiff sues in the capacity of Administratrix of the Estate of Chun Chin, deceased. Said Chun Chin died on the 3rd day of February, 1949, in Honolulu,

City and County of Honolulu, Territory of Hawaii. On the 11th day of March, 1949, she was duly appointed Administratrix of the estate of Chun Chin, deceased, by the Circuit Court of the First Judicial Circuit, Territory of Hawaii, Probate No. 15642, and she has duly qualified as Administratrix of such estate.

IV.

The Territory of Hawaii is a duly incorporated territory. Section 91 of the Organic Act, so far as pertinent, reads:

> "Except as otherwise provided, the public property set and transferred to the United States by the Republic of Hawaii, under the joint resolution of administration approved July 7, 1898, numbered 55(T) (30th S. page 750), shall remain in the possession, use and control of the Government of the Territory of Hawaii, and shall be maintained, managed, and cared for by it, at its own expense until otherwise provided for by Congress, or taken for the United States and possession of the United States by direction of the President or of the Government of Hawaii." 48 U. S. C. A., Sec. 511.

By reason thereof, the Territory of Hawaii became the authorized agent of the defendant in the maintenance, management and care of the public property of the United States within the Territory of Hawaii.

V.

On or about the 30th day of October, 1936, the defendant's authorized agent, Territory of Hawaii, and said Chun Chin entered into a lease agreement, in writing, a copy of which is attached hereto and marked Exhibit "A" and made a part hereof.

That, in pursuance to said lease, said Chun Chin built a new two-story building on said premises and occupied same in 1936, and from 1936, up to the time of the taking by the defendant as hereinafter described, said Chun Chin operated a grocery store and a gasoline service station on said premises.

Chun Chin as duly performed all of the conditions required by said contract to be performed on his part.

VI.

During the latter part of 1943, Acting Secretary of the Navy Forrestal, an official of the defendant, directed Governor I. M. Stainback to take steps to set aside the land described in Exhibit "A" pursuant to the provisions of the statute quoted in Paragraph IV hereof for use of the United States Navy.

VII.

On November 18, 1943, the Government of the Territory of Hawaii issued an executive order setting aside the property described in said lease agreement for the use of the United States Navy, pursuant to the direction of said Secretary of the Navy Forrestal.

VIII.

That in August, 1944, defendant, through its authorized agent, United States Navy at Pearl Harbor, took possession of said property and ousted the plaintiff from said property and occupied the said property up to the present time.

IX.

By virtue of the breach of said contract, said Chun Chin has suffered damages in excess of the sum of $10,000.00 for the loss of his building, his businesses and his lease agreement, but waiving any sum in excess of the total sum of $10,000.00.

Second Count

For a separate and distinct cause of action, plaintiff herein reiterates and realleges the allegations contained in Paragraphs II, III, IV, VI and VIII of the First Count.

I.

The action, brought under Paragraph 20 of Section 24 of the Act of March 3, 1911, 36 Stat. 1093, as amended (U. S. C. Title 28, Sec. 41(20)) as amended, Title 28, U. S. C. (Investigation of 1948), Sec. 1346 (a)(2), is founded upon an implied contract with the Government of the United States.

II.

On or about the 30th day of October, 1936, the

defendant's authorized agent, Territory of Hawaii, permitted said Chun Chin to take possession of the property described in Exhibit "A." Thereafter said Chun Chin built a new two-story building on said premises, and occupied same from 1936 up to the time of taking in August, 1944, by the United States Navy, an authorized agent of the defendant. In October, 1936, said Chun Chin operated a grocery store and gasoline service station on said premises with the consent and knowledge of the defendant. He was prevented in the operation of said businesses in August, 1944.

III.

By reason of the defendant's occupation of said building, said Chun Chin has suffered damages in the sum of $10,000.00 for the loss of said building.

Wherefore, plaintiff demands judgment against the defendant in the sum of $10,000.00, with interest thereon, for the loss of said building, and costs, or in the alternative in the sum of $8,500.00, with interest thereon, for the loss of said building, and $1,500.00, with interest thereon, for the loss of said businesses and lease agreement, and costs.

Dated: Honolulu, T. H., March 31st, 1949.

/s/ HEE KEE CHUN,

Administratrix of the Estate of Chun Chin, deceased, Plaintiff.

EXHIBIT "A"

General Lease No. 2515

This Indenture made this 30th day of October, A.D. 1936, between the Commissioner of Public Lands for and on behalf of the Government of the Territory of Hawaii, of the first part, hereinafter called the lessor, and Chun Chin, of Aiea, Oahu, of the second part, hereinafter called the Lessee, being the highest qualified bidder for the lease duly advertized and sold at public auction in conformity with Section 73 of the Hawaiian Organic Act and the Laws of the Territory of Hawaii:

Witnesseth, That for and in consideration of the rents, covenants and agreements hereinafter reserved and contained, on the part and behalf of the said Lessee, to be paid, kept and performed, he, the said Lessor, by virtue of the authority in him vested, has demised and by these presents does demise and lease unto the said Lessee, all of that portion of the Government Land of

> Aiea, Ewa, Oahu, being Parcel 12-A, Aiea Government Remnants, which parcel of land is more particularly described as follows:
>
> Being portion of the Government land of Aiea situate between the East side of the Oahu Railway & Land Company's Railroad Right-of way (80 feet wide) and the Southwest side of Kamehameha Highway. (N.R.H. 9-A)

Beginning at a pipe at the East corner of this parcel of land, and on the Southwest side of Kamehameha Highway (N.R.H. 9-A), the coordinates

of said point of beginning referred to Government Survey Trig. Station "Salt Lake" being 4387.34 feet North and 8471.20 feet West, as shown on Government Survey Registered Map 2677, and running by azimuths measured clockwise from true South:

1. Along the foot of Bluff along government land, the direct and distance being: 46° 00′ 116.40 feet to a pipe;

2. Thence along the East side of the Oahu Railway & Land Company's Railroad Right-of-way on a curve to the left with a radius of 534.40 feet, the direct azimuth and distance being: 183° 43′ 33″ 100.33 feet to a pipe;

3. 180° 05′ 79.80 feet to a pipe;

4. 177° 29′ 28.60 feet to a pipe;

5. 241° 02′ 44″ 17.65 feet to a pipe;

6. Thence along the Southwest side of Kamehameha Highway (N.R.H. 9-A), on a curve to the right with a radius of 1035.48 feet, the direct azimuth and distance being, 335° 11′ 57″ 150.00 feet to the point of beginning.

Area 0.218 Acre

Subject, however, to an easement right in favor of the Territory of Hawaii for the existing Drain Ditch which crosses this parcel of land as shown on the plan hereto attached and made a part hereof, together with the right of ingress and egress to and from said drain ditch, for maintenance and repairs.

To Have And To Hold, all and singular the said premises herein mentioned and described with the appurtenances, unto the said Lessee, for and during the term of twenty one (21) years, to commence

from the 30th day of October, A.D. 1936: Yielding And Paying therefore the annual rent of Two Hundred and 00/100 Dollars ($200.00), in United States gold coin or currency, payable by equal semi-annual payments in advance, at the office of the Commissioner of Public Lands, in Honolulu, on the 30th day of each October & April of each and every year over and above all taxes, charges and assessments to be levied or imposed thereon by Legislative Authority.

The Lessee does hereby Covenant to and with the Lessor, that the said rent shall be paid in manner aforesaid.

And Also, That the Lessee shall and will from time to time during the term of this lease, pay and discharge all taxes, impositions and assessments, ordinary or extraordinary, which may hereafter, at any time during the continuance of the said term, be laid, imposed, assessed or charged on the said demised premises, or any part thereof, or upon any part thereof, or upon any improvements made or to be made thereon.

And Also, That the Lessee shall and will bear, pay and discharge, at his own cost and expense, all costs and charges for fencing the whole or any part of the above-described premises, if such fencing shall be required by the Lessor, or should be so required by any law now in force, or that may be hereafter enacted, and shall and will maintain the fences so constructed, or previously constructed, in a stockproof condition during the full term of this

lease, and shall and will indemnify the said Lessor of, from and against all damages, costs, expenses and charges which he or the Government of the Territory of Hawaii may at any time sustain by reason or any neglect or refusal of the Lessee in the performance of the premises and agreements last aforesaid.

And Also, That the Lessee shall and will at the end, or other sooner determination of the said term hereby granted peaceably and quietly yield up unto the Lessor all and singular the premises herein demised, with all erections, buildings, and improvements of whatever name or nature, now on or which may be hereafter put, set up, erected or placed upon the same, in as good order and condition in all respects reasonable use, wear, and tear excepted, as the same are at present or may hereafter be put by the Lessee.

And Also, That the Lessee shall not demise, let, set or assign over the said premises, or any part thereof, or assign this lease or any interest therein to any person or persons whomsoever, for any term or time whatsoever, without prior consent in writing of the Lessor.

And The Lessor does hereby covenant to and with the Lessee, that the Lessee shall at all times during the term hereby granted, so long as he shall pay the annual rent, and keep and observe the covenants, conditions and agreements, herein contained, peaceably and quietly have, hold, occupy, possess and enjoy all of the said demised premises, and every

part and parcel thereof, with the appurtenances.

It Is Mutually Agreed, That at any time or times during the term of this lease, the land demised, or any part or parts thereof, may at the option of the Lessor, on behalf of the Territory of Hawaii, or any person or persons, corporation or corporations, be withdrawn from the operation of this lease for homestead or settlement purposes, or for storing, conserving, transporting and conveying water for any purpose, or for reclamation purposes, or for forestry purposes, or for telephone, telegraph, electric power, railway or roadway purposes, or for any public purpose, or for sale for any purpose for which land may be sold under the provisions of Section 73 of the Hawaiian Organic Act as now or hereafter amended, and possession resumed by the Lessor, in which event the land so withdrawn shall cease to be subject to the terms, covenants and conditions of this lease, and the rent hereinabove reserved shall be reduced in proportion to the value of the part so withdrawn.

It Is Also Mutually Agreed And Understood, that the land herein leased is to be used for business purposes, more especially a Gasoline Service Station and appurtenances.

It Is Also Mutually Agreed And Understood, that the Lessee shall, at his own cost and expense, spend not less than Three Thousand and 00/100 Dollars ($3,000.00) for the erection of improvements necessary for the operation of a gasoline service station and appurtenances.

It Is Also Mutually Agreed And Understood, in accordance with the Notice of Sale of this Lease, dated August 21, 1936, (Ad Bk. 12—p. 46.6), that the Lessor reserves, and it does hereby reserve the right of its agents or representatives, and its political subdivisions, to enter or cross the land herein leased, at any time in the performance of their duties.

Provided Always, And these presents are upon this condition that if the rent hereinbefore reserved, shall be unpaid for thirty days after the same is due: or if the Lessee shall fail to well and truly observe, keep or perform any of the covenants and agreements on his part to be observed, kept and performed, or in case the Lessee shall be adjudged bankrupt, then and from thenceforth, in any of the said cases, it shall be lawful for the Lessor, without warrant or other legal process to enter into and upon the said hereby demised premises, or any part thereof, in the name of the whole, and the same to have again, repossess and enjoy, as in his first and former estate and right, and thereby terminate this lease.

Provided Lastly, That the Lessor and Lessee, the successors in office of the said Lessor, and the heirs, executors, administrators and assigns, or the successors and assigns, of the said Lessee, as the case may be, shall be respectively bound by and entitled to the benefit of these presents and to the covenants, conditions, and amends therein contained, in like manner as if the words "successors in office" were inserted next after the word "Lessor" throughout

and as if the words "heirs, executors, administrators and assigns" or the words "successors and assigns," as the case may be were inserted after the word "Lessee" throughout, so far as the nature of the case will permit and unless the context may require a different construction.

In Witness Whereof, The parties hereto have caused this instrument and one other instrument * * * of like date and even tenor herewith to be duly executed upon the day and year first above written.

/s/ L. M. WHITEHOUSE,
Commissioner of Public Lands.

/s/ CHUN CHIN.

City and County of Honolulu,
Territory of Hawaii—ss.

On this 3rd day of December, 1936, before me personally appeared L. M. Whitehouse, Commissioner of Lands for the Territory of Hawaii, to me known to be the person who executed the foregoing instrument and acknowledged that he executed the same as his free act and deed as such Commissioner of Public Lands on behalf of the Territory of Hawaii.

/s/ RACHEL O'SULLIVAN,
Notary Public, 1st Judicial Circuit, Territory of Hawaii.

City and County of Honolulu,
Territory of Hawaii—ss.

On this 2nd day of December, A.D. 1936, before me personally appeared Chun Chin, to me known to be the person described in and who executed the foregoing instrument, and acknowledged that he executed the same as his free act and deed.

/s/ A. APOLIONA,
Notary Public, 1st Judicial Circuit, Territory of Hawaii.

[Title of District Court and Cause.]

SUMMONS

To The Above-Named Defendant:

You are hereby summoned and required to serve upon W. Y. Char, plaintiff's attorney, whose address is 219 Bishop National Bank Branch Building, Honolulu, T. H., an answer to the complaint which is herewith served upon you, within 60 days after service of this summons upon you, exclusive of the day of service. If you fail to do so, judgment by default will be taken against you for the relief demanded in the complaint.

[Seal] /s/ WM. F. THOMPSON, JR.
Clerk of Court.

Dated: March 31, 1949.

Return on Service of Writ

[Title of Cause.]

United States of America,
.....District of.....—ss.

I hereby certify and return that I served the annexed Summons on the therein-named United States of America, Defendant by handing to and leaving a true and correct copy thereof with Ray J. O'Brien, U. S. District Attorney for the District of Hawaii, personally at Honolulu, T. H., in said District on the 4th day of April, A.D. 1949, and by mailing 2 copies by registered mail, return receipt requested to Tom C. Clark, Washington, D. C. (Attorney General of U. S.) on April 4, 1949.

OTTO F. HEINE,
U. S. Marshal.

By /s/ GEORGE E. BRUN,
Deputy.

Return Receipt attached.

[Endorsed]: Filed March 31, 1949.

[Title of District Court and Cause.]

MOTION TO DISMISS

Comes now the United States of America, Defendant above-named, by its Attorney, Ray J. O'Brien, United States Attorney for the District of Hawaii and moves this Honorable Court to dismiss the Complaint filed herein on the following ground:

I.

No claim is stated in the Complaint filed herein upon which relief can be granted by this Honorable Court.

Wherefore, it is respectfully prayed that the Complaint herein be dismissed.

Dated: Honolulu, T. H., this 1st day of September, 1949.

RAY J. O'BRIEN,
United States Attorney,
District of Hawaii,

By /s/ HOWARD K. HODDICK,
Assistant United States
Atty., District of Hawaii.

Receipt of Copy acknowledged.

[Endorsed]: Filed September 2, 1949.

[Title of District Court and Cause.]

RENEWED MOTION TO DISMISS

Comes now the United States of America, Defendant above-named, by Ray J. O'Brien, United States Attorney for the District of Hawaii and states as follows:

I.

A Motion to Dismiss the Complaint filed herein on the ground that no claim is stated in the Complaint upon which relief can be granted by this Honorable Court was filed with a supporting Memorandum of Points and Authorities on September 2, 1949.

II.

The Plaintiff filed a Memorandum of Points and Authorities in Opposition to Motion to Dismiss on July 24, 1950. The Defendant filed a Reply Memorandum on August 31, 1950, and the Plaintiff filed a further Reply Memorandum on September 6, 1950.

III.

The Motion was heard by the Honorable Delbert E. Metzger, Judge, United States District Court for the District of Hawaii on September 13, 1950, and after extensive argument the court denied the Motion without prejudice and gave leave to the Defendant to resubmit the same Motion to the other

Division of this Honorable Court suggesting that there would soon be a change in the calendar and the case would be tried in the other Division of this court.

IV.

The Honorable Delbert E. Metzger further directed that the Defendant did not have to file an Answer to the Complaint until five (5) days after the resubmitted Motion had been disposed of by the other Division of this Court.

Wherefore, the Defendant renews its Motion that the Complaint filed herein be dismissed on the ground that no claim is stated in the Complaint upon which relief can be granted by this Honorable Court and in support of this Motion relies on the memorandum filed with this Court on September 2, 1949, and August 31, 1950.

Dated: Honolulu, T. H., this 14th day of September, 1950.

RAY J. O'BRIEN,
United States Attorney,
District of Hawaii.

By /s/ HOWARD K. HODDICK,
Assistant United States
Atty., District of Hawaii.

Receipt of Copy acknowledged.

[Endorsed]: Filed September 14, 1950.

[Title of District Court and Cause.]

MINUTE ORDER

Whereas, a Motion to Dismiss on the ground that no claim is stated in the Complaint filed herein upon which relief can be granted by this court, was filed by the Defendant on September 2, 1949; and,

Whereas, the said Motion to Dismiss was heard by this Division of this court on September 13, 1950, the Plaintiff being represented by her attorney, W. Y. Char, Esquire, and the Defendant by Howard K. Hoddick, Assistant United States Attorney; and,

Whereas, due to probable early change of calendar, this case, if it proceeds to trial, will likely be tried before the other Division of this court; and,

Whereas, I have considerable doubt in my mind, but not wholly free of uncertainty, that the aforesaid Motion to Dismiss is well founded and think it best to have a final or further ruling on the merits of the Motion made by the Judge who will try the case;

It Is Hereby Ordered that the Motion to Dismiss filed with this court on September 2, 1949, by the Defendant is hereby denied without prejudice, with leave to the Defendant to bring the same matter contained in the Motion to the attention of my associate in the other Division of this court or to such Judge as may try this case; and

It Is Further Ordered that the Defendant may have until five (5) days after such matter has been

disposed of, if Defendant's contentions as to dismissal are not sustained, to answer the complaint filed herein.

Dated: Honolulu, T. H., this 18th day of September, 1950.

s/ DELBERT E. METZGER,
Judge, United States
District Court.

[Endorsed]: Filed September 18, 1950.

In the United States District Court
for the District of Hawaii

Civil No. 905

HEE KEE CHUN, Administratrix of the Estate of Chun Chin, Deceased,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

ORDER

The defendant herein having filed a renewed motion to dismiss the complaint on the ground that no cause of action upon which relief can be granted by this court is stated therein, and said motion having been heard by this court on September 26, 1950, the plaintiff being represented by her attorney, W. Y. Char, Esquire, and the defendant by Howard K. Hoddick, Assistant United States Attorney, and this court having found that no cause of action upon which relief can be granted by this court is stated in the complaint;

It Is Hereby Ordered and Adjudged that the complaint be and is dismissed.

Dated at Honolulu, T. H., this 26th day of September, 1950.

/s/ J. FRANK McLAUGHLIN,
Judge, U. S. District Court.

[Endorsed]: Filed September 27, 1950.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Hee Kee Chun, Administratrix of the Estate of Chun Chin, deceased, plaintiff above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the final order entered in this case on the 27th day of September, 1950.

Dated: Honolulu, T. H., this 5th day of October, 1950.

W. Y. CHAR and
SAU UNG CHAN,
Attorneys for Plaintiff.

By /s/ W. Y. CHAR.

[Endorsed]: Filed October 5, 1950.

[Title of District Court and Cause.]

ORAL RULING

In the above-entitled matter held at Honolulu, T. H., September 26, 1950.

Before: Hon. J. Frank McLaughlin,
Judge.

Appearances:

W. Y. CHAR, ESQ.,

Appealing for the Plaintiff.

HOWARD K. HODDICK, ESQ.,
Assistant U. S. Attorney,
Appearing for the Defendant.

Honolulu, T. H., September 26, 1950

The Clerk: Civil No. 905, Hee Kee Chun vs. United States of America. Hearing on Motion to Dismiss.

The Court: Oh, yes. Are the parties ready to proceed?

Mr. Char: Yes, your Honor.

Mr. Hoddick: Ready for the movant, your Honor.

The Court: Very well, you may do so.

(Argument on motion by Mr. Hoddick and Mr. Char.)

The Court: This is a motion to dismiss on the ground that the Complaint does not state a cause

of action under the Tucker Act. I am inclined to believe the motion is well taken, which likewise was the opinion of Judge Metzger.

It is quite clear to me on the facts alleged that no claim under the Tucker Act against the Federal Government is stated. The lands involved were at all times the public property of the United States. It held title thereto, although, under the provisions of Section 91 of the Organic Act, possession was given to the Territory of Hawaii. When the deceased took possession of the lands in question under a contract, or a lease, with the Territory, he did so with full knowledge of the provisions of Section 91 of the Organic Act and all other pertinent laws.

Clearly, as to the improvements, the provisions of the lessee's contract with the Territory provided that at the termination of the lease, namely, at the end or other sooner determination, all improvements erected upon the land of a permanent nature by the lessee shall become the property of the Territory. There is no dispute in facts here but what these improvements were of a permanent nature and permanently affixed to the land. Under the provisions of law and of this lease, when fixtures are attached to the land permanently, they become part of the land and belong to the owner of the land, which in this instance was the United States.

Additionally is that proposition fortified by this provision of the lease with the Territory, and the taking back of its public lands by the Federal

Government through the Territorial Governor's Act here is within the scope of the phrase "or other sooner determination of this lease."

The bringing of the lease to an end makes those improvements the property of the owner of the fee, which in this instance is the Federal Government. So I am satisfied that, applying the law to the facts alleged in this Complaint, the motion is well taken, that the Complaint does not spell out in either of its alleged causes of action an implied contract under the Tucker Act; consequently, a failure to state a claim over which this Court has jurisdiction; the motion is well taken and is granted.

It may be, perhaps, as suggested by the Ninth Circuit, and now suggested by this Court, and likewise expressing no opinion, but it does seem to me that if this party has any claim at all, it would lie in the direction of the Territory and not the Federal Government. But, again I repeat: I am expressing no opinion as to whether or not this Estate's claim against the Territorial Government would or would not, under Territorial law, be well taken. All I am called upon to decide is whether or not the cause of action here in this Complaint, in either of the counts, as stated, under the Tucker Act, is a good claim against the United States.

I find, to repeat myself, that in point of law, taking the facts as pleaded as true, they do not spell out a cause of action under either of the counts under the Tucker Act; and for those rea-

sons, as I have said, the motion as to each count is granted.

Mr. Char: May I note an exception and note an appeal.

(Discussion between Court and Council as to time for appeal.)

(Thereupon, at 11:45 a.m. hearing in the above-entitled matter was adjourned.)

Reporter's Certificate

I, Lucille Hallam, Official Reporter, United States District Court, District of Hawaii, do hereby certify that the foregoing is a true and correct transcript of my shorthand notes taken in Civil No. 905, Hee Kee Chun, etc., vs. United States of America, held at Honolulu, T. H., September 26, 1950, of the Oral Ruling of Hon. J. Frank McLaughlin, Judge.

Oct. 11, 1950.

/s/ LUCILLE HALLAM.

[Endorsed]: Filed November 2, 1950.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

United States of America,
District of Hawaii—ss.

I, Wm. F. Thompson, Jr., Clerk of the United States District Court for the District of Hawaii, do hereby certify that the foregoing record on appeal in the above-entitled cause, consists of the following listed original pleadings and transcript of proceedings:

Complaint and Summons.
Motion to Dismiss.
Renewed Motion to Dismiss.
Minute Order.
Order.
Notice of Appeal.
Designation of Record on Appeal (Appellant).
Designation of Record on Appeal (Appellee).
Oral Ruling (Transcript of Proceedings) September 26, 1950.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court, this 8th day of November, 1950.

[Seal] s WM. F. THOMPSON, JR.,
Clerk, United States District Court, District of Hawaii.

[Endorsed]: No. 12732. United States Court of Appeals for the Ninth Circuit. Hee Kee Chun, Administratrix of the Estate of Chun Chin, deceased, Appellant, vs. United States of America, Appellee. Transcript of Record. Appeal from the United States District Court of the District of Hawaii.

Filed November 10, 1950.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals for the Ninth Circuit

Civil No. 905

HEE KEE CHUN, Administratrix of the Estate of CHUN CHIN, Deceased,

Plaintiff-Appellant,

vs.

UNITED STATES OF AMERICA,

Defendant-Appellee.

STATEMENT OF POINTS

Comes now Hee Kee Chun, Administratrix of the estate of Chun Chin, deceased, Plaintiff-Appellant, in the above-entitled cause, and states that she

intended to rely on the following points on her appeal to this Honorable Court:

1. The Court erred in granting the motion to dismiss the complaint for failure to state a claim upon which relief can be granted.

2. The Court erred in holding that under provisions of law and of the lease, the Plaintiff-Appellant's decedent had no compensable interest in the improvements.

3. The Court erred in assuming that the Defendant-Appellee repossessed Parcel 12-A under the lease.

4. The Court erred in holding that the repossession was within the contemplation of the terms of the lease.

W. Y. CHAR and
SAU UNG CHAN,

By /s/ W. Y. CHAR,
Attorney for Plaintiff-Appellant.

Receipt of copy acknowledged.

[Endorsed]: Filed November 10, 1950.

No. 12,732

IN THE

United States Court of Appeals

For the Ninth Circuit

HEE KEE CHUN, Administratrix of the Estate of Chun Chin, Deceased,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

On Appeal from the District Court of the United States for the Territory of Hawaii.

BRIEF FOR APPELLANT.

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JURISDICTION.

The jurisdiction of the United States District Court for the Territory of Hawaii is founded upon Par. 20, Section 24 of the Act of March 3, 1911, 36 Stat. 1093, as amended (U.S.C. Title 28, Sec. 41 (20)) as amended, Title 28 U.S.C. (investigation of 1948) Section 1346 (a) (2). Judgment was entered in the District Court on September 27, 1950. (R. 22.) The jurisdiction of this Court is founded upon 28 U.S.C.A., Section 1293.

STATEMENT OF FACTS.

Appellant's decedent went into possession of Parcel 12-A under a general lease (Exhibit A, R. 8) from the Territory requiring him to construct and operate a gasoline service station, which he did. The lease term was for 21 years, from 1936, with an option in the Territory to "withdraw" land from the lease for certain purposes enumerated in the lease contract, such withdrawal to result in proportionate reduction in rental. The lease also contained a non-removal clause whereby the lessee was to yield the premises with all improvements thereon at the end or "other sooner determination" of the lease.

The United States began condemnation proceedings against Parcel 12-A, which were later discontinued when it was found that title to this parcel was in itself. *Chun Chin v. U. S.,* 150 Fed. (2d) 1016 (1945). The United States then went into possession of the said parcel following the Territorial Governor's executive order, such order being made pursuant to a request by the then United States Acting Secretary of the Navy, Forrestal, acting under Section 91 of the Organic Act. As a result, appellant's decedent was ousted from the premises and no compensation whatever was paid him, either by the Territory or the United States.

In the Court below, appellee conceded appellant's right to recovery under the Tucker Act provided that the decedent Chun Chin had a compensable property right in the improvements. The lower Court held that under the provisions of law and of this lease, the

appellant could not recover, and granted the appellee's motion to dismiss. Appellant appeals.

QUESTION PRESENTED.

1. Does a lessee of public lands from the Territory of Hawaii have no compensable interest in his lease when such land is taken by the United States under Section 91 of the Organic Act?

SPECIFICATION OF ERRORS.

1. The Court erred in granting the motion to dismiss the complaint for failure to state a claim upon which relief can be granted.

2. The Court erred in holding that under provisions of law and of the lease, the appellant's decedent had no compensable interest in the improvements.

3. The Court erred in assuming that the appellee repossessed Parcel 12-A under the lease.

4. The Court erred in holding that the repossession was within the contemplation of the terms of the lease.

SUMMARY OF ARGUMENT.

The lessee's possession of land and improvements was taken by the United States under Section 91. There is nothing in the Organic Act which justifies

such a taking without compensation. Congress allows the Territory to sell and to lease public lands in Section 73 of the Organic Act. Obviously, those public lands which are sold in fee could not be repossessed without compensation by the United States by virtue of Section 91. Why the different result where public lands are leased under Section 73? True, condemnation proceedings may not be the appropriate procedure where leased public lands are concerned because the method of retaking those lands is set out in Section 91 (*Chun Chin v. United States,* 150 Fed. (2d) 1018), but the property interest of a lessor is no less a compensable interest than that of a purchaser of fee title, and the only difference is that the lessee must bring suit under the Tucker Act.

Assuming that the United States can disregard the lease and repossess the *land* without compensation under Section 91, the United States must still pay for the *improvements.* A right to compensation for improvements, even where "permanent" and on public lands, is recognized under federal law in condemnation suits. 43 *U.S.C.A.* Section 936; *Washington & I. R. Co. v. Osborn,* 160 U.S. 103, 16 S. Ct. 219 (1895). Furthermore, improvements of the nature presently involved do not become "part of the land" under the leading case of *Van Ness v. Pacard.* The clause preventing removal of improvements by the lessee at the end or other sooner determination of the lease only limits the lessee's interest to the use of the improvements to the unexpired term but does not extinguish such interest.

The "other sooner determination" clause in the lease does not apply to the repossession made by the United States. It contemplates a determination made under the lease—and here, repossession was made under Section 91 of the Organic Act.

There was no "withdrawal" *under* the withdrawal clause of the lease. The option to withdraw is confined to specific purposes, and federal purposes are not included.

But even if it is to be deemed that the present repossession was made under the withdrawal clause, a scrutiny of the entire lease shows that compensation for improvements was contemplated. Exercise of the option to withdraw results in the specific consequences set out in the withdrawal clause, and not the general consequences contemplated by the "other sooner determination" clause. Indeed, a harsh construction such as that proposed by the appellee would result in the Territory's having no lease customers, contrary to the purpose of the Hawaiian leasing system.

ARGUMENT.

I.

DECEDENT LESSEE HAD A COMPENSABLE PROPERTY INTEREST UNDER THE ORGANIC ACT.

A. Section 91 does not give the United States the power to repossess a lease interest without compensation.

The appellee contended below that inasmuch as Section 91 gave the United States the right to re-

possess at any time, the Territory had "no estate in lands"—that it had merely a "revocable license or a mere tenancy at will" not recognized as a property interest under the Fifth Amendment—and that the Territory could give no more to the lessee than it had. The lower Court apparently gave credit to this patently erroneous contention. Whatever the correctness of the construction given to Section 91 by appellant as to defining the relationship between the United States and the Territory, the further attempt to deduce from that relation the nonexistence of a property right in those who take under the Territory is mistaken.

First: The Territory has the power to "give more than it had". Section 91 does not stand alone; it must be read together with Section 73, which details the Territory's powers as to disposition of public lands. Section 73(1) contains a proviso that public lands may be sold (i.e., fee conveyed) for residence and other enumerated purposes, and the Land Commissioner of the Territory has conveyed *fee title* to such land pursuant to this provision for fifty years. How can it be said that these home owners, because they got their title through the Territory and are deemed to have notice of Section 91 have only a "revocable license" or a "mere tenancy at will"? Section 73(d) contains a proviso that certain public lands may be leased without any provision for withdrawal. Can it be said that because of Section 91, these leases are only "revocable licenses"? The general lessee also acquires his interest "in conformity with Section 73". Exhibit A. (R. 8.)

Second: The appellee's contention creates a contradiction between Section 91 and Section 73 in that while Section 73 permits the Territory to create fee and term interests in purchasers and lessees, Section 91 would reduce those definite interests to "mere licenses". But such an absurdity cannot be attributed to Congress. It is more reasonable that Congress intended that Section 91 was to define the relation between the United States and the Territory alone. Upon annexation, certain lands were ceded to the United States; these public lands were put in the possession of the Territory to be managed by it with the profits from such use going into the Territorial treasury, but such lands were to be used by the Territory only "until otherwise provided for by Congress, or taken for the uses and purposes of the United States by direction of the President or of the Governor of Hawaii". Should the Territory create interests in public lands in others than the Territory (namely, lessees or purchasers under Section 73), then as to them, the provisions of Section 91 do not have the effect of making them subject to deprivation without compensation—and it is only after the Territory regains rightful possession from its lessees that the United States has a right to repossess from the *Territory* under Section 91 without compensation.

Although in the cases of outright purchase of the fee title under Section 73(l), it can hardly be contended that the United States may retake without compensation under Section 91 because the Territory had "no estate" to convey, the argument for retaking

is made more plausible where a lease is concerned because the thing called "title" is not transferred. However, it needs no citation of authorities to declare that a lessee has a legally recognized interest just as much as a fee owner—though his interest be of a smaller quantum.

As to the purchasers of the fee under Section 73(1), the United States would have to condemn to divest those purchasers of their property. As to leaseholders, a similar result would seem to follow. However, this Court has decided that condemnation is not the *appropriate proceeding* (*United States v. Chun Chin,* 150 Fed. (2d) 1018 (1945)) since Section 91 provided the *method* whereby the United States could repossess leased lands, but that case did not deny that a lessee had a compensable property interest in the lease. Appellant maintains that a lessee's property interest in the leasehold arises from the same Section 73 of the Organic Act and in the same manner as the purchasers of the fee title, and the only difference between the two types of interest is that leaseholders must maintain their claim under the Tucker Act rather than in a condemnation suit. In short, payment for the leasehold must still be made.

Third: It is easy to presume that all who deal with the Territory are deemed to have knowledge of the Organic Act. But the question arises: what does the Organic Act tell them? It tells them that they may buy fee title to public lands from the Territory under 73(1). Does it go further and tell them that despite such purchase, the United States can retake

that land without compensation because under Section 91 the Territory had nothing to sell? It tells them that they may lease public lands from the Territory. Does it go further and tell them that despite such lease, the United States can repossess that land without compensation because under Section 91 the Territory had nothing to lease? Even where less drastic results were intended, Congress made explicit provisions to apprise those who would transact business with the Territory. In framing Section 73(d) as to the withdrawal of leased land suitable for *agriculture* (not the instant parcel) Congress provided:

> "* * * The land, or any part thereof so leased, may at any time during the term of the lease be withdrawn from the operation thereof for homestead or public purposes, in which case the rent reserved shall be reduced in proportion to the value of the part so withdrawn. *Every such lease shall contain a provision to that effect* * * *" (Italics ours.)

Contrasted with the broad provisions in Section 91, the conclusion is compelled that Congress did not intend an inequitable "joker" in Section 91 whereby the United States really gave nothing to those who dealt with the Territory although it purported to do so under Section 73.

The question as to what interests and rights a lessee gets from the Territory really involves two queries: (1) What does a lessee get under Section 73? He gets customary land interests well known to law—i.e., fees and lease terms. (2) What is the effect

of Section 91 on those interests? Section 91, as to leaseholds, under the *Chun Chin* case, provides a procedure (substituted for condemnation) whereby the United States may retake the land. Section 91 does not affect the property interest in any other way. The appellant submits that the conclusion is irresistible that the decedent lessee's interest in the unexpired lease term and the improvements for such unexpired term was not one which could not be given by the Territory, and was not one which the United States could retake under Section 91 without compensating therefor.

B. Assuming that the United States could repossess leased public lands under Section 91 without compensation, the lessee had a compensable interest in the improvements.

Even if it be assumed that leased public lands are subject to a retaking under Section 91 without compensation (although certainly sold public lands would not—and both leased and sold public lands are conveyed by the Territory under Section 73), it does not follow that the lessee loses his interest in the improvements which he put on. The lower Court seemed to think that because the improvements were of a "permanent" nature, they became "part of the land", and since the land "belonged" to the United States, the United States could take the improvements without compensating the lessee.

Under the leading case of *Van Ness v. Pacard,* 2 Pet. (U.S.) 137, 7 L. Ed. 374 (1829), the improvements here involved would be removable but for the non-removal clause. 107 A.L.R. 1153, esp. 1158-59.

The non-removal clause provides that the lessor gets the improvements "at the end or other sooner determination" of the lease—and they become "part of the land" at that time. But there was no "end or other sooner determination". (See infra pages 15-17 of this brief.)

But even if the improvements be deemed "part of the land" because of the non-removal clause, it does not follow that compensation for the improvements need not be made. A property interest in those who improve United States-owned lands is recognized under federal law:

> "The legislature of the proper Territory may provide for the manner in which private lands and *possessory claims on the public lands* of the United States may be condemned * * *." 43 *U.S.C.A.*, Section 936. (Italics ours.)

And the fact that the possessor's interest may consist of buildings ("permanent") is not, *per se,* reason for concluding that inasmuch as it is part of the land and the land "belongs" to the United States, therefore, the United States may make any disposition of the land without compensation being given to the possessor. *Washington & I. R. Co. v. Osborn,* 160 U.S. 103, 16 S. Ct. 219 (1895); *Spokane Falls & N. Ry. v. Ziegler,* 167 U.S. 65, 17 S. Ct. 728 (1897); *Union Pacific Rr. v. Harris,* 215 U.S. 386, 30 S. Ct. 138 (1910). In the *Osborn* case, the possessor went into possession of United States lands and built a house thereon, intending to file under the pre-emption laws, but before he perfected title in himself,

Congress disposed of the land to the railroad. The railroad, which took through the Congressional act and must be considered as taking in the right of the United States, refused to compensate the possessor for the taking. The Supreme Court said:

> "It must, therefore, be conceded that Osborn did not, by maintaining possession for several years and putting valuable improvements thereon, preclude the government from dealing with the lands as its own, and from conferring them on another party by a subsequent grant. On the other hand, it would not be easy to suppose that Congress would, in authorizing railroad companies to traverse the public lands, intend thereby to give them a right to run the lines of their roads at pleasure, regardless of the rights of settlers." *Washington & I. R. Co. v. Osborn,* supra, at p. 109.

The fact that the present claim is instituted under the Tucker Act should make no difference in the recognition of this property right.

Like the *Osborn case,* it may be assumed that the United States had a right to repossess Parcel 12-A (being public land) under Section 91 of the Organic Act. On the other hand, it is not easy to suppose that by reserving this right to repossess, Congress intended that any valuable improvements on such public lands would be taken at pleasure without compensation. Certainly there is nothing in the Organic Act nor in any "other pertinent laws" which indicate, much less compel, such a harsh result.

The decedent-lessee's recovery may be less because of the limited term and the non-removal of improvements at the end of such term, but his interest is nevertheless a legally recognized one. *Corrigan v. City of Chicago,* 144 Ill. 537, 33 N.E. 746 (1936); *Mayor, etc., of Baltimore v. Camse Bros.,* 132 Md. 290, 104 Atl. 429 (1918).

In the lower Court, the appellee likened the decedent's possession to a "tenancy at will" or a "revocable license" because of Section 91, and cited the following cases to support the proposition that such a tenancy or license was not property under the Fifth Amendment:

United States v. Inlots, 26 Fed. Cas. No. 15 (1873);

Hanna v. County of Hampden, 250 Mass. 107, 145 N.E. 258 (1924);

Tate v. State Highway Comm., 226 Mo. App. 1216, 49 S.W. (2d) 282 (1932);

Shaaber v. Reading City, 150 Pa. 402, 24 Atl. 692 (1892);

Lyons v. Railway Co., 209 Pa. 550, 58 Atl. 924 (1904);

United States v. Chandler-Dunbar Co., 229 U.S. 53, S. Ct. (1913);

Potomac Electric Power v. United States, 85 Fed. (2d) 243 (App. D. C. 1936), cert. denied 299 U.S. 565.

The *Chandler-Dunbar* case concerned property rights in water power and is clearly unrelated to the case at bar. The *Shaaber* case denied a claimant ask-

ing for the expenses of moving out and is inapplicable here. The rest of the cases dealt with claimants who wanted compensation for their term (i.e., duration) interests, and they were denied recovery because their possession of the premises could be cut off at any time. However, whenever improvements were involved, the Courts expressly distinguished the bald rule that a tenant at will cannot recover. *Tate v. State Highway Comm., supra; Potomac Electric Power v. United States, supra.* In the *Potomac* case, which like the instant case involved repossession by the United States of lands to which it had title, the Federal Court said:

> "A somewhat different situation is presented as to the equipment installed in the public alley in Square 144, and in D. Street, which separated squares 144 and 145. This equipment was physically taken, because of the closing of the alley and the street, but this gave rise to a claim which is not properly involved in this condemnation proceeding. If valid, it constitutes a separate and distinct cause of action which defendant may prosecute in the Court of Claims." 85 Fed. (2d) 243 at 249.

Thus, assuming that the United States could repossess the land under Section 91, labeling decedent's interest as a "revocable license" or a "tenancy at will" does not answer the decedent's claim. Rather, the cases show that the interest in improvements, even where a claimant could not insist upon a continuance of the term, has always been recognized in condemnation proceedings—and, in the case where the United States

itself was the recipient of the improvements incident to a repossession of land to which it had title, in proceedings before the Court of Claims. See also *United States v. North American Transportation and Trading Co.,* 253 U.S. 330, 40 S. Ct. 518 (1920).

The appellee contended below that the phrase "at its own expense" in Section 91 was notice that the United States would not pay for the improvements —that the appellee must look only to the Territory. However, the plain meaning of the phrase in context is that the administration and upkeep of public lands while in the Territory's possession would be a Territorial expense (justly so for the profits from such management go into the Territorial treasury—Section 73(e) of the Organic Act)—that is, expenses for maintaining, caring for, and managing were to be borne by the Territory as between it and the U. S. Section 91 itself is silent as to payments to be made by the United States for benefits which it receives when it repossesses land on which valuable improvements have been erected on the faith of leases which it authorized the Territory to make.

II.

REPOSSESSION BY THE UNITED STATES WAS NOT WITHIN THE "OTHER SOONER DETERMINATION" CLAUSE IN THE LEASE.

The lower Court ruled that re-possession by the United States was within the lease clause providing for "other sooner determination" of the lease. Upon

such determination, the land and improvements would be yielded up to the lessor (i.e., the Territory). It would follow, if the lower Court's ruling were correct, that the lessee's interest would be extinguished and there would be nothing for which the United States could be said to have impliedly contracted to pay.

First: The mere statement of the effect of "other sooner determination" reveals that taking by the United States was not contemplated by this phrase. Upon such determination the lease contract provides that the land and improvements would go to the *Territory*—but here, they went to the United States.

Second: In the lease contract itself are provided several ways of sooner ending the term, namely by option to terminate for breach of covenants and by option to withdraw for certain enumerated purposes. It can only be that at most "sooner determination" under these options were meant—options to be exercised by the lessor (Territory).

Third: There is no express provision as to Federal repossession. The guide to interpretation is found in the language of the Supreme Court of Hawaii:

> "Leases of public lands, like leases of private lands, are entered into by lessees because they think they see an opportunity for deriving some beneficial profit to themselves from the temporary use of the property, but ordinarily, in order to secure this end the land is desired only if it can be definitely assured to the lessee for a stated period. The right of the lessor to withdraw the whole or any part of the lands at any time purely at his or its option is not ordinarily

> granted and is not freely to be inferred unless the language used clearly requires it. Had it been the intention of the parties of this instrument to grant to the Territory the very large powers of withdrawal now claimed, much simpler and more direct language could have been used to express that intention and understanding." *Ai v. Bailey,* 30 Haw. 210, 213 (1927).

Thus, it can hardly be said that the instant repossession by the United States was within the "other sooner determination" clause of the lease. It therefore cannot be said that lessee's interest was extinguished by virtue of repossession by the United States.

III.

THE LEASE WAS NOT TERMINATED UNDER THE LEASE PROVISIONS.

The lower Court ruled that under the provisions of Section 91 of the Organic Act and "other pertinent laws" and under the terms of the lease contract, the decedent-lessee had no compensable property right. The foregoing discussion of Section 91 and Section 73 of the Organic Act and of the phrase "other sooner determination" should be determinative of the lessee's rights. It should be noted that the possession by the United States was taken, as alleged in the complaint (R. 3), pursuant to Section 91 (cf. *U. S. v. Chun Chin,* supra, p. 2, at footnotes 1 and 2), and that the land was not withdrawn under the provisions of the lease. Therefore, the United States cannot take the

position that the *Territory* withdrew the lease pursuant to contract, and its liability must be determined under the Organic Act rather than the lease contract.

The lower Court's reference to lease provisions apparently was to the non-removal of improvements under the "other sooner determination" clause. It has already been shown that this clause is inapplicable to the instant taking by the United States (Argument II) insofar as "determining" the lease is concerned; and that it only limits, but does not extinguish, a lessee's property interest in the improvements (this brief, page 14). However, out of an abundance of caution, appellant will further argue the possibility that the lower Court may have meant that the land was withdrawn as per the withdrawal clause found in the lease itself.

Can it be said that, in spite of the facts of this case, the United States took possession under the withdrawal clause in the lease? Options such as this must be strictly construed. *Ai v. Bailey,* supra, p. 16. The withdrawal clause provides for withdrawal in two situations: (1) for "homestead or settlement purposes, or for storing, conserving * * * or for any public purpose"; (2) or "for sale for any purpose for which land may be sold under the provisions of Section 73 of the Hawaiian Organic Act".

Section 73(q) of the Hawaiian Organic Act as it stood when the lease was executed in 1936 provided that "All orders setting aside land for forest or other public purposes, or withdrawing the same, shall be

made by the governor, and lands while so set aside for such purposes may be managed as may be provided by the laws of the Territory". That shows very clearly that the "public purposes" mean the public purposes of the Territory, hence the provision that when so set aside the lands would be managed "as may be provided by the laws of the Territory". It could not have meant withdrawal of land for federal purposes would be managed, not according to the laws of the Territory but according to federal law.

In harmony with this view, the lease provides that "The land demised, or any part or parts thereof, may at the option of the lessor, on behalf of the Territory of Hawaii, or any person or persons, corporation or corporations, be withdrawn from the operation of this lease for homestead or settlement purposes * * * or for any public purpose * * * and possession resumed by the lessor * * *". The phrase "any public purpose" as there used meant a public purpose of the Territory as in the Organic Act. In the event that the land be withdrawn from the lease the possession would be "resumed by the lessor", who is the Commissioner of Public Lands acting for the Territory of Hawaii. Land withdrawn for the purposes of the federal government would not be taken possession of by the Commissioner of Public Lands but by the federal authorities.

When it became apparent that it would be advisable to authorize the withdrawal of land for federal purposes, Congress made appropriate provision therefor by enacting the statute of August 21, 1941 (55

Stat. 658, Ch. 394) by which Section 73(q) of the Organic Act was amended. That section, as so amended, provides that "all orders setting aside lands for forest or other public purpose, or withdrawing the same, shall be made by the governor, and lands while so set aside for such purposes may be managed as may be provided by the laws of the Territory; that provisions of this section may also be applied where the 'public purposes' are the uses and purposes of the United States, and lands while so set aside may be managed as may be provided by the laws of the United States." (48 U.S.C.A. Section 677; Revised Laws of Hawaii 1945, p. 42.) If Section 73(q) of the Organic Act as it originally stood authorized the withdrawal of leased land for federal purposes, the passage of that act would not have been necessary.

Furthermore, *ejusdem generis* would confine the "public purpose" for which land may be withdrawn to Territorial purposes.

The provision in the lease that land may be withdrawn "for sale for any purpose for which land may be sold under the provisions of Section 73 of the Hawaiian Organic Act as now or hereafter amended" has no application here because we are not dealing with a sale of land. The phrase "as now or hereafter amended" does not apply to the withdrawal of land for other purposes than for sale.

It may be that leases made since August 21, 1941, may be subject to the right of withdrawal for federal purposes, but it is our contention that the Act of Con-

gress then passed was not intended to have and did not have a retrospective operation so as to impose an additional burden on lessees who held under leases previously made under which land was withdrawable only for the purposes of the Territory. Their rights were vested rights for the duration of the terms of their respective leases according to the provisions and agreements set forth in their leases.

The Supreme Court, in the case of *Southwestern Coal and Improvement Company v. McBride,* 185 U.S. 499, 503, referring to the Act of Congress called the Curtis Act, quoted approvingly the language of the Circuit Court of Appeals as follows:

> "While, in the absence of a constitutional inhibition, the legislature may give to some of its acts a retrospective operation, the intention to do so must be clearly expressed, or necessarily implied from what is expressed; and assuming the legislature to possess the power, its act will not be construed to impair or destroy a vested right under a valid contract unless it is so framed as to preclude any other interpretation."

That case was cited with approval in *United States Fidelity & Guaranty Co. v. United States for the use of Struthers Wells Co.,* 200 U.S. 306, 314, where the Court, construing an amendatory Act of Congress, said:

> "There are certain principles which have been adhered to with great strictness by the courts in relation to the construction of statutes, as to whether they are or are not retroactive in their effect. The presumption is very strong that a

> statute was not meant to act retrospectively, and it ought never to receive such a construction if it is susceptible of any other. It ought not to receive such a construction unless the words used are so clear, strong and imperative that no other meaning can be annexed to them, or unless the intention of the legislature cannot be otherwise satisfied."

There is absolutely nothing in the language in the Act of Congress here involved that would warrant, much less require, that it be given a retrospective operation which would trample on a vested right.

Thus, even apart from the allegation in the complaint, it cannot be said that a withdrawal under the option in the lease occurred.

IV.

ASSUMING A WITHDRAWAL UNDER THE LEASE, THE DECEDENT-LESSEE HAD A COMPENSABLE INTEREST IN THE IMPROVEMENTS.

If the United States may be deemed to have withdrawn under the lease, then, one of the conditions of withdrawal was that the lessee would be paid for the improvements.

The lease provides for non-removal of the improvements at the end of 21 years or "other sooner determination" of the lease. It is true that, assuming a proper withdrawal, the lessee would have no right to the unexpired term. And this ending of the lease by

withdrawal would seem to be subsumed under the term "other sooner determination". However, a scrutiny of the whole lease shows that a termination of the lease under the withdrawal clause is not within the contemplation of the "other sooner determination" consequence as to improvements.

The "determination" contemplated by this phrase is confined to those situations where a lessee has been at fault and the lessor terminates the lease because of a breach of one or more of the numerous covenants which the lessee made. "At the end" of the term obviously means at the end of 21 years. The word "determination" imports, like the word "terminate", the exercise of an option in the landlord. Cf. *Kramer v. Ambery,* 4 N.Y.S. 613, 15 Daly 205 (1889). The specific option of withdrawal being particularly provided for, the area in which the lessor could exercise his option to "determine" the lease was where the lessee failed "to well and truly observe, keep, or perform any of the covenants and agreements on his part to be observed, kept and performed, or in case the lessee shall be adjudged bankrupt" and the lessor elected to repossess and "thereby terminate this lease". (Quotes from the lease contract.) This interpretation finds significant support in the Hawaiian statutes themselves: provsions which, in substance, specifically permit the Territory to insist on forfeiture *for conditions or covenants breached* and declare that the estate of the lessee shall "thereby determine", are found in the Organic Act, Section 73(h), Section

4551 of the Revised Laws, 1945, and Section 1615 of the Revised Laws, 1935. It is submitted that in these provisions is found the source of the true meaning of the phrase "or other sooner determination".

Furthermore, the withdrawal clause provides for a withdrawal of "land" with a specific and equitable consequence upon such withdrawal, namely a pro-rata reduction in rent. Had a forfeiture of a lessee's interest in valuable improvements which the lessee was under obligation to erect been contemplated, it would have been simple to have stated that *"land and improvements"* were subject to withdrawal. The provision for pro-rata rental reduction shows that improvements were not contemplated, for it can readily be seen that if improvements were subject to withdrawal without compensation, this provision's attempt to be fair could never succeed were the withdrawal made the day after the improvements were erected. In contrast, the provision for repossession upon breach by the lessee declares that the lessor may "terminate this lease". There is no provision for any further consequences, and it may be inferred that the consequences upon "other sooner determination" apply here.

That improvements were to be paid for upon a withdrawal before the full term of the lease is a reasonable conclusion when it is remembered, as was stated in appellee's brief in the lower Court, that the purpose of the general lease was (1) to encourage

financially able lessees to develop public land for later withdrawing for homesteading, and (2) to obtain revenue. It is hardly to be imagined that these aims of Hawaiian land laws would be promoted by the harsh interpretation now contended for by appellee.

The inclusion of the particular non-removal clause found in the instant lease is not inconsistent with appellant's interpretation of the lease contract (that there was no thought of surrendering the right to compensation until the end of 21 years). Had a right to remove been reserved, then actual removal would have been the only remedy opened to appellant's decedent and he could not have asked for compensation. *Maguire v. Gomes,* 17 Haw. 493 (1906). *Worthington v. Young,* 8 Ohio 401 (1838). The impracticability of this particular remedy is readily apparent, and it is more reasonable that the appellant's decedent should contemplate reimbursement rather than dislocated physical assets.

Added to the foregoing is the strict rule of construction against forfeitures. 51 C.J.S. 677, Section 1021.

CONCLUSION.

For the foregoing reasons, it is respectfully submitted that the order of the lower Court should be reversed and the motion to dismiss be denied.

Dated, Honolulu, Hawaii,
February 2, 1951.

Respectfully submitted,
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No. 12732

In the United States Court of Appeals for the Ninth Circuit

HEE KEE CHUN, ADMINISTRATRIX OF THE ESTATE OF CHUN CHIN, DECEASED, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE TERRITORY OF HAWAII

BRIEF FOR THE UNITED STATES

A. DEVITT VANECH,
Assistant Attorney General,
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CITATIONS

936213—51

In the United States Court of Appeals for the Ninth Circuit

No. 12732

HEE KEE CHUN, ADMINISTRATRIX OF THE ESTATE OF CHUN CHIN, DECEASED, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE TERRITORY OF HAWAII

BRIEF FOR THE UNITED STATES

OPINION BELOW

The district court did not write an opinion. Its oral ruling appears in the Record at pp. 24–27.

JURISDICTION

This is an appeal from a judgment of dismissal entered September 27, 1950 (R. 22). Notice of appeal was filed October 5, 1950 (R. 23). The jurisdiction of the district court was sought to be invoked under the Tucker Act, 28 U. S. C. sec. 1346 (a) (2). The jurisdiction of this Court rests upon 28 U. S. C. sec. 1291.

QUESTION PRESENTED

Whether a person in possession of public lands of the United States under a general lease from the

Territory of Hawaii has any compensable interest in the lands or improvements thereon when the lands are withdrawn for public use by the United States, in view of the provisions of Section 91 of the Organic Act and of the lease.

STATUTE INVOLVED

The pertinent portion of Section 91 of the Hawaiian Organic Act of April 30, 1900, 31 Stat. 159, 48 U. S. C. sec. 511, is set forth in the argument, *infra,* pp. 5–6.

STATEMENT

This case is a sequel to that of *United States* v. *Chun Chin,* 150 F. 2d 1016 (C. A. 9, 1945), and involves the same question, recently determined by this Court in favor of the Government in No. 12,680, *United States* v. *A. Lester Marks, et al.* (Opinion March 5, 1951), as to whether the United States is under any liability to the holder of a general lease from the Territory of Hawaii when public lands are withdrawn from such lease for use by the United States pursuant to Section 91 of the Organic Act. The factual background is as follows:

In the latter part of 1936, Chun Chin, appellant's predecessor, and the Territory of Hawaii entered into a general lease agreement by which public lands of the United States, left in the control of the Territory by Section 91 of the Organic Act, were leased to Chun Chin for a 21-year term beginning on October 30, 1936, for use in the operation of a gasoline service station (R. 4–5, 8–14). As required by the terms of the lease, Chun Chin constructed a building on the

premises at a cost of not less than $3,000.00 (R. 5, 12). The lease contained the following provisions (R. 11, 12):

> And Also, That the Lessee shall and will at the end, or other sooner determination of the said term hereby granted peaceably and quietly yield up unto the Lessor all and singular the premises herein demised, with all erections, buildings, and improvements of whatever name or nature, now on or which may be hereafter put, set up, erected or placed upon the same, in as good order and condition in all respects reasonable use, wear, and tear excepted, as the same are at present or may hereafter be put by the Lessee.
>
> * * * * *
>
> It is Mutually Agreed, That at any time or times during the term of this lease, the land demised, or any part or parts thereof, may at the option of the Lessor, on behalf of the Territory of Hawaii, or any person or persons, corporation or corporations, be withdrawn from the operation of this lease for homestead or settlement purposes, or for storing, conserving, transporting and conveying water for any purpose, or for reclamation purposes, or for forestry purposes, or for telephone, telegraph, electric power, railway or roadway purposes, or for any public purpose, or for sale for any purpose for which land may be sold under the provisions of Section 73 of the Hawaiian Organic Act as now or hereafter amended, and possession resumed by the Lessor, in which event the land so withdrawn shall cease to be subject to the terms, covenants and conditions of this

> lease, and the rent hereinabove reserved shall be reduced in proportion to the value of the part so withdrawn.

In 1940, the United States instituted proceedings to condemn several tracts, including the one here involved, for use in connection with the naval base at Pearl Harbor, but when it was discovered that title to the Chun Chin tract was already in the United States, the Government moved to dismiss the parcel from the condemnation proceeding. The motion was denied. *United States* v. *Chun Chin,* 150 F. 2d 1016–1017 (C. A. 9, 1945). Thereupon, the Secretary of the Navy requested that the Governor of Hawaii set aside the land for use of the Navy Department pursuant to the provisions of Section 91 of the Organic Act, and on November 18, 1943, the Governor issued an executive order complying with the request (R. 5). Shortly thereafter the parcel came on for trial in the condemnation proceeding. The Government renewed its motion for dismissal, which was denied, and judgment was entered awarding $8,500.00 as the value of the improvements. *United States* v. *Chun Chin,* 150 F. 2d 1016, 1017 (C. A. 9, 1945). On appeal this Court reversed and directed the dismissal of the parcel from the condemnation proceeding, holding that in view of the provisions of Section 91, condemnation was not an appropriate procedure for effecting a transfer of the property, and that it was unnecessary to consider whether the lessee had any right of compensation for improvements. *United States* v. *Chun Chin,* 150 F. 2d 1016, 1017–1018 (C. A. 9, 1945).

Although the parcel had been set aside for the use of the Navy Department in November 1943, Chun Chin's possession was not disturbed until August 1944 (R. 5, 6, 7), which was subsequent to the trial of, but prior to this Court's decision in *United States* v. *Chun Chin,* 150 F. 2d 1016. Chun Chin having died, appellant in the capacity of administratrix of his estate instituted this Tucker Act suit on March 31, 1949, to recover for the loss of his building, business and lease agreement (R. 3–16).

The Government moved to dismiss the complaint for failure to state a cause of action (R. 17), and Judge Metzger denied the motion without prejudice and with leave to renew the motion in another division of the court (R. 20–21). Accordingly, the Government renewed its motion before Judge McLaughlin (R. 18–19, 24–27), and on September 26, 1950, an order of dismissal was entered (R. 22). This appeal followed (R. 23).

ARGUMENT

Whatever interest was created by the lease of public lands in Hawaii, it was subject to defeasance without payment of compensation when the land was needed for purposes of the United States

Title to the lands here involved has been in the United States since annexation (see R. 4–5). As to such lands, Section 91 of the Organic Act of April 30, 1900, 31 Stat. 159, as amended, 48 U. S. C. sec. 511, provides:

> Except as otherwise provided, the public property ceded and transferred to the United States by the Republic of Hawaii, under the

> joint resolution of annexation * * * shall remain in the possession, use, and control of the government of the Territory of Hawaii, and shall be maintained, managed, and cared for by it, at its own expense, until otherwise provided for by Congress, or taken for the use and purposes of the United States by direction of the President or of the Governor of Hawaii. * * *

By direction of the Governor, the parcel was taken from the control of the Territory for the use of the United States Navy (R. 5–6).[1]

By the plain language of Section 91 and of the terms of the lease as to withdrawal (*supra,* pp. 3–4), it is clear that the United States is under no obligation to make any compensation to the holder of a general lease from the Territory when the leased lands should be retaken for federal purposes. This Court so held in *United States* v. *A. Lester Marks, et al.* (No. 12,680, March 5, 1951), and, in so holding, rejected arguments to the contrary which are substantially the same as made by appellant here. In consequence, the Government is filing herein a motion to affirm the judgment below on the basis of the decision in the *Marks* case.

Appellant contends that, even if the parcel could be withdrawn without any requirement for compensation for the land, there nevertheless was a right to compensation for the building erected by Chun Chin as required by the lease (Br. 10–15, 22–25). In the *Marks* case, this Court has already rejected such a

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[1] The Governor's order is set out in the record in *United States* v. *Chun Chin*, No. 10808, at pages 46–53.

contention by striking from the judgment an item awarding the rental value of improvements. And, in view of the lease provision for yielding up all improvements, including those erected by him, at the end or sooner determination of his lease (R. 11), it would seem that there could not be any basis for such a contention. Since the lessee clearly waived any right to remove improvements, it is plain that his only interest therein was a right of use during the existence of his lease. *Corrigan* v. *City of Chicago,* 144 Ill. 537, 549–550, 33 N. E. 746 (1893); *Mayor & C. C. of Baltimore* v. *Gamse,* 132 Md. 290, 295–296, 104 Atl. 429 (1918). Thus, when the lease was terminated by the withdrawal, all the lessee's interest in the improvements was likewise brought to an end. *United States* v. *21,815 Square Feet of Land, etc.,* 155 F. 2d 898 (C. A. 2, 1946). If it had been contemplated that in the event of a withdrawal the lessee would retain an interest in the improvements, it would have been an easy matter to provide for such an exception in the "other sooner determination" clause.

Moreover, even without consideration of the terms of the lease, it does not appear that there exists any ground for recovery by appellant. It is well established that a person erecting improvements on public lands has no rights therein when the lands are reserved for public purposes, unless he has acquired some vested right, as against the United States, in the land itself. *Russian-American Co.* v. *United States,* 199 U. S. 570 (1905). And the authorities relied upon by appellant (Br. 11–12) are not to the contrary. The statutory provision (43 U. S. C. sec.

936) is not of general application, but is a part of the Act of March 3, 1875, 18 Stat. 482, granting railroad rights-of-way over public lands.[2] And the cases cited (Br. 11) clearly recognize that Congress could have made an absolute grant to the railroads which would have wiped out the possessory claims, and hold only that in making such grants Congress required the railroads to make payment to the settlers. *Washington & Idaho Railroad* v. *Osborn,* 160 U. S. 103, 109 (1895); *Spokane Falls &c. Railway* v. *Ziegler,* 167 U. S. 65, 73 (1897); *Union Pacific R. R. Co.* v. *Harris,* 215 U. S. 386, 388–389 (1910). But they do not indicate that, absent the consent of Congress, the United States would have been required to make compensation. Neither Section 91 of the Organic Act nor any other statute imposes such a liability in the instant case.

Neither does the opinion in *Potomac Electric Power Co.* v. *United States,* 85 F. 2d 243 (C. A. D. C., 1936), certiorari denied 299 U. S. 565, offer any comfort to appellant. That part of the opinion quoted by appellant (Br. 14) refers to the ordinary right of a licensee to remove improvements that he has erected within a reasonable time after cancellation of his license. Cf. 2 Thompson on Real Property (1939), sec. 721. But here Chun Chin specifically waived all right to remove improvements and all other interest therein.

[2] Even if it were of general application as part of the land laws of the United States, it would be of no assistance to appellant, because such laws are not applicable in Hawaii. Joint Resolution of Annexation (July 7, 1898), 30 Stat. 750, 48 U. S. C. sec. 661.

Moreover, if all interest in improvements had not terminated upon cancellation of the lease, it is plain that such termination was effected by lapse of time. The lease was cancelled by the withdrawal order of November 18, 1943 (R. 5), while the Government did not take possession until sometime in the following August (R. 6). The interval afforded ample time for the removal or salvage of the building. Clearly, such delay is fatal to the instant claim. Cf. *Maguire* v. *Gomes,* 17 Haw. 493 (1906).

CONCLUSION

For the foregoing reasons, it is submitted that the judgment of the district court should be affirmed.

Respectfully,

A. DEVITT VANECH,
Assistant Attorney General,
HOWARD K. HODDICK,
United States Attorney,
Honolulu, Hawaii,
ROGER P. MARQUIS,
JOHN C. HARRINGTON,
Attorneys, Department of Justice,
Washington, D. C.

MARCH 1951.

U. S. GOVERNMENT PRINTING OFFICE: 1951

No. 12733

United States
Court of Appeals
for the Ninth Circuit.

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a Corporation, Bankrupt,

Appellant.

vs.

R. M. WILEY,

Appellee.

Transcript of Record

**Appeal from the United States District Court,
Eastern District of Washington,
Northern Division.**

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS OF RECORD

EGGERMAN, ROSLING & WILLIAMS,
918 Joseph Vance Bldg.,
Seattle 1, Washington,
Attorneys for Plaintiff and Appellant.

HUGHES & JEFFERS,
501 Doneen Bldg.,
Wenatchee, Washington,
Attorneys for Defendant and Appellee.

In the United States District Court for the Eastern District of Washington, Northern Division

In Bankruptcy No. 742

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, Bankrupt,

Plaintiff,

vs.

R. M. WILEY,

Defendant.

COMPLAINT

Plaintiff alleges as follows:

1. The action arises under Section 70 of the Act of Congress relating to Bankruptcy, (U.S.C. Title 11, Chapter 7, Sec. 110) as hereinafter more fully appears.

2. At all times herein mentioned Northwest Chemurgy Cooperative was and is now a Washington corporation hereinafter sometimes referred to as "Chemurgy."

3. On May 29, 1947, Chemurgy duly filed a Petition for an Arrangement under Chapter XI of the Act of Congress relating to Bankruptcy in the United States District Court for the Western District of Washington, Northern Division, Cause No. 37569. On said date said Court entered an order accepting and approving Chemurgy's Petition for an Arrangement as properly filed under Chapter XI of said Act.

4. Chemurgy was unable to consummate the proposed Arrangement and upon a hearing duly noticed and held pursuant to Section 376 (2) of the Act of Congress relating to Bankruptcy, said Court on December 13, 1947, duly made and entered its order that Chemurgy is a Bankrupt under said Act and that Bankruptcy be proceeded with pursuant to the provisions of said Act.

5. Subsequent to said order determining Chemurgy a Bankrupt, after proceedings duly had therefore, plaintiff on January 6, 1948, was by the order of said Court duly appointed Trustee of the estate of said Bankrupt and thereafter on said January 6, 1948, plaintiff duly qualified as Trustee of said estate and since said date at all times has been the duly appointed, qualified and acting Trustee of the estate of said Bankrupt.

6. At all times herein mentioned Sections 5831-4 and 5831-6 of Remington's Revised Statutes of the State of Washington (Laws of 1941, Ch. 103), Secs. 1 and 3 were in full force and effect. Said statutes provide as follows:

"5831-4, Preference by insolvent corporations—Definition. Words and terms used in this act shall be defined as follows: (a) "Receiver" means any receiver, trustee, common law assignee, or other liquidating officer of an insolvent corporation. (b) "Date of application" means the date of filing with the Clerk of the Court of the petition or other application for the appointment of a receiver, pursuant to which application such appointment is made, or

in case the appointment of a receiver is lawfully made without court proceedings, then it means the date on which the receiver is designated, elected or other wise authorized to act as such. (c) "Preference" means a judgment procured or suffered against itself by an insolvent corporation or a transfer of any of the property of such corporation, the effect of the enforcement of which judgment or transfer at the time it was procured, suffered, or made, would be to enable any one of the creditors of such corporation to obtain a greater percentage of his debt than any other creditor of the same class. L. '41, ch. 103, Sec. 1"

"5831-6 Preference voidable when—Trust fund doctrine superseded. Any preference made or suffered within four (4) months before the date of application for the appointment of a receiver may be avoided and the property or its value recovered by such receiver. No preferences made or suffered prior to such four (4) months' period may be recovered, and all provisions of law or of the trust fund doctrine permitting recovery of any preference made beyond such four (4) months' period are hereby specifically superseded. L. '41, ch. 103, Sec. 4"

7. For at least four (4) months immediately prior to May 29, 1947, Chemurgy was unable to pay its debts in the ordinary course of business and was insolvent within the meaning of said statutes of the State of Washington.

8. Within said four months' period Chemurgy

being then insolvent paid to the defendant above named a total of $2,252.78 upon an antecedent debt or debts then past due and owing by Chemurgy to said defendant upon which defendant is entitled to an offset of $ None for credit given within said four months' period.

9. The effect of such payment is to enable the said defendant to obtain a greater percentage of the indebtedness due to said defendant than other creditors of the same class.

Wherefore, plaintiff prays for judgment against the defendant in the sum of $2,252.78 with interest and with costs taxes in favor of the plaintiff and against the defendant.

EGGERMAN, ROSLING & WILLIAMS,

/s/ DeWITT WILLIAMS,
Attorneys for plaintiff.

[Endorsed]: Filed May 28, 1948.

[Title of District Court and Cause.]

SUMMONS

To the above named Defendant: R. M. Wiley

You are hereby summoned and required to serve upon Eggerman, Rosling & Williams, plaintiff's attorneys, whose address is 918 Joseph Vance Building, Seattle 1, Washington, an answer to the complaint which is herewith served upon you, within

twenty days after service of this summons upon you, exclusive of the day of service. If you fail to do so, judgment by default will be taken against you for the relief demanded in the complaint.

A. A. LaFRAMBOISE,
Clerk of Court.

[Seal] By /s/ EVA M. HARDIN,
Deputy Clerk.

Date: May 28, 1948.

Return on Service of Writ attached.

[Endorsed]: Filed June 5, 1948.

[Title of District Court and Cause.]

MOTION TO DISMISS

Comes Now the defendant, R. M. Wiley, by his attorneys, Hughes & Jeffers and Sam R. Sumner, Sr., and respectively moves the Court for the entry herein of an order dismissing the above-entitled action, upon the grounds that the plaintiff's complaint herein fails to state a claim upon which relief may be granted.

In support of this motion there is hereto attached statement of the reasons upon which defendant bases this motion.

Dated this 17th day of August, 1948.

HUGHES & JEFFERS,
By /s/ JOSEPH L. HUGHES,
/s/ SAM R. SUMNER, SR.,
Attorneys for Defendant.

Statement of Reasons Why the Foregoing Motion For Dismissal Should Be Granted

In this action plaintiff seeks to recover moneys paid to the defendant by plaintiff corporation during the period from January 29, 1947, to May 29, 1947, on the grounds that such payments were preferences and voidable under the provisions of §§ 5831-4 and 5831-6 of Remington Revised Statutes of the State of Washington (Laws of 1941, Ch. 103).

It is defendant's contention that § 5831-5 of Remington's Revised Statutes of the State of Washington (Laws of 1941, Ch. 103, Sec. 2) was in full force and effect at all times mentioned in plaintiff's complaint. That said section provides as follows:

> "§ 5831-5—Action to Recover—Limitation. If not otherwise limited by law, actions in the court of this State by a receiver to recover preferences may be commenced at any time within, but not after, six (6) months from the date of application for the appointment of such receiver."

That the trustee, who is relying on the provisions of § 5831 Remington Revised Statutes of Washington as authority for his right to recover in this proceeding, is required to accept all conditions of the statute, which grants the existence of his right to recover. (Dugger vs. Hamilton National Bank, 29 Fed. Supp. 1021). In the case at bar the date of application for

the appointment of such receiver, as contemplated by the statute, was the 29th day of May, 1947, on which date the Northwest Chemurgy Cooperative, a corporation, filed its petition for an arrangement under Chapter XI of the Act of Congress relating to bankruptcy in the U. S. District Court for the Western District of Washington, Northern Division, Cause No. 37569 (Tit. 11, § 378 (2)). Consequently, the right granted the trustee under the State statute to recover preferential payments terminated on November 29, 1947.

[Endorsed]: Filed August 19, 1948.

[Title of District Court and Cause.]

ORDER DENYING MOTION TO DISMISS

The motion of the defendant to dismiss this action came on regularly for hearing before the undersigned Judge of the above-entitled Court on August 23rd, 1948, the parties being represented in court by their attorneys of record herein. The Court heard the argument of counsel and thereafter considered the briefs filed on behalf of the parties. On January 5th, 1948, the Court made and filed his opinion herein denying said motion.

Now, Therefore, in accordance with said opinion and ruling and pursuant thereto, it is hereby ordered that defendant's said motion to dismiss be and the

same is hereby denied. The exception of the defendant is noted.

Done in Open Court this 27th day of January, 1949.

/s/ SAM M. DRIVER,
Judge.

Presented by:

/s/ DeWITT WILLIAMS,
Of attorneys for plaintiff.

Approved as to Form for Entry:
HUGHES & JEFFERS,
Attorney for defendant.

[Endorsed]: Filed January 27, 1949.

[Title of District Court and Cause.]

AGREED STATEMENT OF FACTS

It Is Agreed by and between the above-named plaintiff and defendant that this action may be tried to the court upon the following agreed statement of facts:

I.

At all times herein mentioned Northwest Chemurgy Cooperative was and is now a Washington corporation, hereinafter referred to as Chemurgy. On May 29, 1947, Chemurgy duly filed a petition for an arrangement under Chapter XI of the Act of Congress relating to Bankruptcy in the United States District Court for the Western District of

Washington, Northern Division, Cause No. 37569. On said date said court entered an order accepting and approving Chemurgy's petition for an arrangement as property filed under Chapter XI of said Act. Chemurgy was unable to consummate the proposed arrangement and upon a hearing duly noticed and held pursuant to §376 (2) of the Act of Congress relating to Bankruptcy, said court on December 13, 1947, duly made and entered its order that Chemurgy is a bankrupt under said Act and that bankruptcy be proceeded with pursuant to the provisions of said Act. Subsequent to said order determining Chemurgy a bankrupt after proceedings duly had therefor, plaintiff, on January 6, 1948, was by the order of said court duly appointed Trustee of the estate of said bankrupt and thereafter on said January 6, 1948, plaintiff duly qualified as Trustee of said estate and since said date at all times has been the duly appointed, qualified and acting Trustee of the estate of said bankrupt. At all times herein material §5831-4 and §5831-6 of Rem. Rev. Stat. of the State of Washington (Laws of 1941, Chap. 103, Sections 1 and 3) were in full force and effect. For at least four months immediately prior to May 29, 1947, Chemurgy was unable to pay its debts in the ordinary course of business and was insolvent within the meaning of said statutes of the State of Washington. During all of said four months and at the present time there existed and now exists against said insolvent corporation and said bankrupt estate claims of general unsecured creditors on file with said court in said bankruptcy proceeding, upon

which claims from the inception thereof as debts of the corporation no payment has been made. The claims allowed and allowable are greatly in excess of the estate assets.

II.

On January 27, 1947, the defendant R. M. Wiley, a resident of Waterville, Washington, sold and delivered to Chemurgy at Wenatchee, Washington, 79,510 lbs. of wheat at $1.70 per bushel, for a total purchase price of $2252.78. At the time of said sale on said date he personally received from Chemurgy its check No. 7237, dated January 27, 1947, payable to said defendant, and drawn on the Wenatchee Valley Branch of The Seattle-First National Bank. Defendant first deposited said check for payment in the Waterville Branch of The National Bank of Commerce on February 6, 1947, and said check was paid by The Wenatchee Valley Branch of The Seattle-First National Bank out of the funds of Chemurgy then on deposit with said bank on February 7, 1947.

III.

The original of said check No. 7237 will be filed with the court as an exhibit on the trial of this action.

IV.

On May 8, 1948, said Trustee made demand on the defendant for the return of said alleged preferential payment in the sum of $2252.78, but the defendant has failed and refused to return said amount or any portion thereof to the Trustee or the bankrupt estate.

Question for Decision

The question for decision by the court under the facts of this case is whether or not the payment of said check by the Wentachee Valley Branch of The Seattle-First National Bank on February 7, 1947, out of the account of Chemurgy in said bank was a preference in the amount of $2252.78 within the meaning of a preference as defined in Rem. Rev. Stat. §5831-4 (c).

The foregoing facts and question for the court are hereby agreed to this 28th day of February, 1950.

EGGERMAN, ROSLING & WILLIAMS,
By /s/ DeWITT WILLIAMS,
Attorneys for Plaintiff.

HUGHES & JEFFERS,
By /s/ JOSEPH L. HUGHES,
Attorneys for Defendant.

[Endorsed]: Filed April 10, 1950.

[Title of District Court and Cause.]

MOTION FOR REHEARING AND RECONSIDERATION

Comes Now the plaintiff and moves the court for an order setting down this case for reargument and reconsideration.

This motion is based upon the fact that defendant filed no brief at the time of argument or since said date and the oral argument on behalf of defendant

at that time was likewise very brief. The Court has ruled upon the basis of a brief filed in another action which brief was based on certain facts not present in this case.

It is respectfully submitted that if the arguments contained in said other brief (Cause No. 745) as raised in said other briefs are to be applied to this action the plaintiff should have an opportunity to argue this action orally to the court in response to the points raised in said other briefs.

EGGERMAN, ROSLING & WILLIAMS,
Attorneys for plaintiff.

[Endorsed]: Filed August 7, 1950.

[Title of District Court and Cause.]

ORDER

Plaintiff's Motion for Rehearing and Reconsideration in the above-entitled case is hereby denied.

Dated this 7th day of August, 1950.

/s/ SAM M. DRIVER,
United States District Judge.

[Endorsed]: Filed August 7, 1950.

[Title of District Court and Cause.]

RECORD OF OBJECTIONS TO ACTION OF THE COURT AND REQUEST FOR ACTION AT THE TIME OF THE SIGNING AND ENTRY OF FINDINGS OF FACT AND CONCLUSIONS OF LAW

Be It Remembered that at the time of and as a part of the signing and entry of the findings of fact and conclusions of law and judgment herein the plaintiff, pursuant to Rule 46 of the Rules of Civil Procedure made known to the court his objections to the action of the court and made known to the court the action which he desired the court to take, as follows:

Objections to Action of the Court

1. Plaintiff objected to the entry of that portion of the finding of fact III reading: "That the plaintiff has failed to sustain the burden of proving the transaction constitutes an unlawful preference and was other than a cash transaction" on the grounds (a) that the facts stipulated prove that the payment of the check referred to in finding II on February 7, 1947, was a preference within the meaning of Rem. Rev. Statute 5831-4 and (b) that the transaction referred to in finding II was not a cash transaction and (c) said quotation of purported finding is not contained in the stipulation of facts.

2. Plaintiff objected to the entry of conclusion of law I on the grounds: (a) that the conclusion of

law to be drawn from the stipulated facts was that the payment on February 7, 1947, referred to in finding II was a preference within the meaning of Rem. Rev. Statutes § 5831-4, (b) that the transaction referred to therein was not a cash transaction as held by the court, (c) that the evidence, facts and finding of facts do not support the statement "* * * there was no intent on the part of either party to create a debtor-creditor relationship" (d) the intent of the parties is immaterial.

3. Plaintiff objected to conclusion of law II that defendant was entitled to have a judgment dismissing the complaint on the ground (a) that the stipulated facts and pertinent law require the entry of judgment as prayed for in the complaint.

4. Plaintiff objected to the entry of judgment dismissing the complaint on the ground that the stipulated facts require, as a conclusion of law, that the payment to defendant of the sum of $2,252.78 on February 7, 1947, was a preference in said amount within the meaning of Rem. Rev. Statute § 5831-4 (c) and was recoverable under Rem. Rev. Stat. §5831-6 by the plaintiff herein from the defendant.

5. Plaintiff objected to the failure of the court to answer the question for decision presented by the agreed statement of facts by holding that payment on February 7, 1947, to the defendant was a preference in the amount of said payment within the meaning of a preference as defined in Rem. Rev. Stat. §5831-4 (c).

At said time plaintiff also made known to the court that he wished the following action to be taken on the ground that such action was required by the stipulated facts and the conclusion of law to be drawn therefrom under the law relating to the recovery of preferential payments as contained in Rem. Rev. Stat. § 5831-4 and Rem, Rev. Stat. § 5831-6:

1. That the court enter the following conclusions of law instead of the conclusions entered by the court:

(a) "The payment of said check out of the funds of Chemurgy on deposit with the Wenatchee Valley Branch of The Seattle-First National Bank on February 7, 1947, was a transfer to the defendant of the property of said insolvent Northwest Chemurgy Cooperative, within the meaning of Rem. Rev. Stat. §5831-4 and a preference recoverable by the plaintiff from the defendant under Rem. Rev. Stat. of the State of Washington §5831-4 and §5831-6.

(b) Plaintiff is entitled to judgment against the defendant R. M. Wiley in said sum of $2,252.78 with interest thereon at the rate of 6% per annum from May 8, 1948, until paid and for plaintiff's costs herein to be taxed.

2. That the court enter judgment for the plaintiff and against the defendant in accordance with the foregoing conclusion of law.

The foregoing record of objections made and

request for action of the court made this 29th day of September, 1950, at the time of and as a part of the signing and entry of findings of fact, conclusions of law and judgment herein.

Done by the Court.

/s/ SAM M. DRIVER,
Judge.

The foregoing approved for signing and entry by the court at the time of signing and entry of findings, conclusions and judgment.

/s/ JOSEPH L. HUGHES,
Of Attorneys for Defendant.

Presented by:

/s/ DeWITT WILLIAMS,
Of Attorneys for Plaintiff.

[Endorsed]: Filed September 29, 1950.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled action came on regularly for trial before the undersigned Judge of the above-entitled Court upon a written statement of agreed facts made and filed by the parties, the plaintiff being represented in Court by his attorneys of record, Eggerman, Rosling and Williams, and DeWitt Williams, and the defendant being represented in Court by his attorneys, Hughes & Jeffers and Joseph L. Hughes, and the Court having considered the facts as agreed and heard the argument of counsel and after due consideration of written briefs filed by both parties; now, therefore, the Court finds the facts in accordance with said agreed statement of facts as follows:

Findings of Fact

I.

At all times herein mentioned Northwest Chemurgy Cooperative was and is now a Washington corporation, hereinafter referred to as Chemurgy. On May 29, 1947, Chemurgy duly filed a petition for an arrangement under Chapter XI of the Act of Congress relating to Bankruptcy in the United States District Court for the Western District of Washington, Northern Division, Cause No. 37,569. On said date said Court entered an order accepting and approving Chemurgy's petition for an arrangement as properly filed under Chapter XI of said Act. Chemurgy was unable to consummate the

proposed arrangement and upon a hearing duly noticed and held pursuant to § 376 (2) of the Act of Congress relating to Bankruptcy, said Court on December 13, 1947, duly made and entered its order that Chemurgy is a bankrupt under said Act and that bankruptcy be proceeded with pursuant to the provisions of said Act. Subsequent to said order determining Chemurgy a bankrupt after proceedings duly had therefor, plaintiff on January 6, 1948, was by the order of said Court duly appointed Trustee of the estate of said bankrupt and thereafter on said January 6, 1948, plaintiff duly qualified as Trustee of said estate and since said date at all times has been the duly appointed, qualified and acting Trustee of the estate of said bankrupt. At all times herein material §5831-4 and §5831-6 of Rem. Rev. Stat. of the State of Washington (Laws of 1941, Chap. 103, §1 and 3) were in full force and effect. For at least four months immediately prior to May 29, 1947, Chemurgy was unable to pay its debts in the ordinary course of business and was insolvent within the meaning of said statutes of the State of Washington. During all of said four months and at the present time there existed and now exists against said insolvent corporation and said bankrupt estate claims of general unsecured creditors on file with said court in said bankruptcy proceeding, upon which claims from the inception thereof as debts of the corporation no payment has been made. The claims allowed and allowable in said bankruptcy proceedings are greatly in excess of the estate assets.

II.

On January 27, 1947, the defendant R. M. Wiley, a resident of Waterville, Washington, sold and delivered to Chemurgy at Wenatchee, Washington, 79,510 lbs. of wheat at $1.70 per bushel, for a total purchase price of $2,252.78. At the time of said sale on said date he personally received from Chemurgy its check No. 7237 dated January 27, 1947, payable to said defendant, and drawn on the Wenatchee Valley Branch of the Seattle-First National Bank in said sum of $2,252.78. Defendant first deposited said check for payment in the Waterville branch of the National Bank of Commerce on February 6, 1947, and said check was paid by the Wenatchee Valley Branch of the Seattle-First National Bank out of the funds of Chemurgy then on deposit with said bank on February 7, 1947. The original of said check has been admitted as an exhibit at the trial of this action.

III.

On May 8, 1948, said Trustee made demand on the defendant for the return of said alleged preferential payment in the sum of $2,252.78, but the defendant has failed and refused to return said amount or any portion thereof to the Trustee or the bankrupt estate.

That the plaintiff has failed to sustain the burden of proving that the transaction constituted an unlawful preference and was other than a cash transaction.

From the foregoing Findings of Fact, the Court draws the following

Conclusions of Law

I.

That payment of said check out of the funds of Chemurgy on deposit with the Wenatchee Valley Branch of the Seattle-First National Bank on February 7, 1947, was not such a transfer to the defendant of the property of said insolvent Northwest Chemurgy Cooperative as to constitute an unlawful preference within the meaning of Rem. Rev. Stat. of the State of Washington, §5831-4, as the transaction was in substance and effect a cash transaction and there was no intent on the part of either party to create a debtor-creditor relationship.

II.

That defendant is entitled to have entered a judgment against the plaintiff, Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, dismissing plaintiff's complaint with prejudice and awarding defendant judgment for costs herein to be taxed in the sum of $20.00.

The foregoing Findings of Fact and Conclusions of Law made and entered this 29th day of September, 1950.

/s/ SAM M. DRIVER,
Judge.

Approved as to form, subject to "Record of Ob-

jections," notice of presentation waived.

/s/ DeWITT WILLIAMS,
Of Attorneys for Plaintiff.

Presented by:

/s/ JOSEPH L. HUGHES,
Of Attorneys for Defendant.

[Endorsed]: Filed September 29, 1950.

In the District Court of the United States for the Eastern District of Washington, Northern Division

No. 742

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a Corporation, Bankrupt,

Plaintiff,

vs.

R. M. WILEY,

Defendant.

JUDGMENT

This matter came on regularly before the undersigned judge of the above-entitled Court for trial on April 10, 1950, upon an agreed statement of facts made and filed by the parties hereto, plaintiff being represented in Court by his attorneys, Eggerman, Rosling & Williams, and DeWitt Williams, and the defendant being represented in Court by his attorneys, Hughes & Jeffers, and Joseph L.

Hughes, and the Court having made and entered its Findings of Fact and Conclusions of Law requiring entry of judgment for the defendant in accordance with his answer herein; now, therefore, pursuant to said Findings and Conclusions, it is hereby

Ordered, Adjudged and Decreed that the plaintiff's complaint herein be dismissed with prejudice.

It Is Further Ordered, Adjudged and Decreed that the defendant R. M. Wiley be and he is hereby granted judgment against the plaintiff, Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, bankrupt, for his costs herein to be taxed by the Clerk, in the sum of $20.00.

This judgment made and entered this 29th day of September, 1950.

/s/ SAM M. DRIVER,
Judge.

Approved as to form, subject to "Record of Objections," notice of presentation waived.

/s/ DeWITT WILLIAMS,
Of Attorneys for Plaintiff.

Presented by:

/s/ JOSEPH L. HUGHES,
Of Attorneys for Defendant.

[Endorsed]: Filed September 29, 1950.

[Title of District Court and Cause.]

NOTICE OF APPEAL

To: R. M. Wiley, defendant and to Hughes & Jeffers and Joseph L. Hughes, his attorneys.

You and Each of You are hereby notified that the above named plaintiff, Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a Corporation, Bankrupt, does hereby appeal to the United States Court of Appeals for the Ninth Circuit from the final judgment rendered and entered in the above-entitled cause on September 29, 1950, and from each and every part thereof.

Dated this .. day of October, 1950.

EGGERMAN, ROSLING & WILLIAMS,

/s/ DeWITT WILLIAMS,

Attorneys for Plaintiff Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative.

Copy of This Notice of Appeal mailed Hughes & Jeffers and Joseph L. Hughes, attorneys for defendant, this 19 day of October, 1950.

A. A. LaFRAMBOISE,
Clerk.

By /s/ EVA N. HARDIN,
Deputy Clerk.

[Endorsed]: Filed October 19, 1950.

[Title of District Court and Cause.]

COST BOND ON APPEAL

Know All Men by These Presents: That we, Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, Bankrupt, as Principal, and United Pacific Insurance Company, as Surety, acknowledge ourselves to be jointly indebted to United States of America, appellee in the above cause, in the sum of Two Hundred Fifty and No/100 ($250.00) Dollars, conditioned that, Whereas, on the 29th day of September, 1950, in the District Court of the United States for the Eastern District of Washington, in a suit pending in that court, wherein Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, Bankrupt, was Plaintiff and R. M. Wiley was Defendant, a judgment was rendered against the said Plaintiff and the Plaintiff having filed in the office of the Clerk of the said District Court a notice of appeal therefrom to the United States Court of Appeals for the Ninth Circuit.

Now the Condition of the Above Obligation Is Such, that if the said Plaintiff shall prosecute his appeal to effect and answer all costs, if the appeal is dismissed or the judgment affirmed, or of such costs as the appellate court may award if the judgment

is modified, then the above obligation is void, else to remain in full force and effect.

Signed, sealed and dated this 9th day of October, 1950.

/s/ ADOLPH W. ENGSTROM,
Trustee in Bankruptcy for
NORTHWEST CHEMURGY
COOPERATIVE, A CORP.,
BANKRUPT,
UNITED PACIFIC
INSURANCE COMPANY.

[Seal] By /s/ ARMAND MINORCHIO,
Attorney-in-Fact.

Countersigned:

/s/ TILESTON GRINSTEAD,
Resident Agent,
Seattle, Washington.

[Endorsed]: Filed October 19, 1950.

[Title of District Court and Cause.]

DESIGNATION OF RECORD ON APPEAL

To the Clerk of Said Court:

Herewith we hand you Notice of Appeal and Bond on Appeal in the above entitled cause.

Will you please prepare the Record on Appeal in the manner provided by Rule 75, consisting of all proceedings and evidence in this action, which the appellant understands to consist of the following:

1. Summons and Return of Service.

2. Complaint.

3. Answer.

4. Agreed Statement of Facts.

5. All Exhibits.

6. Motion for Rehearing and Reconsideration.

7. Order Denying Motion for Rehearing and Reconsideration.

8. Findings of Fact and Conclusions of Law.

9. Judgment.

10. Record of Objections to Action of the Court, and Request for Action.

11. Notice of Appeal.

12. Bond on Appeal.

13. Motion to Dismiss.

14. Order Denying Motion to Dismiss.

15. Designation of Record.

/s/ DeWITT WILLIAMS,
EGGERMAN, ROSLING &
WILLIAMS,

Attorneys for Plaintiff and Appellant Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative.

Receipt of Copy acknowledged.

[Endorsed]: Filed October 27, 1950.

PLAINTIFF'S EXHIBIT NO. 1

NORTHWEST CHEMURGY CO-OPERATIVE

MANUFACTURERS OF

STARCH - GLUCOSE - DEXTROSE AND BY-PRODUCTS

GENERAL OFFICE. 126 SO. WENATCHEE AVE.

No. 7237

WENATCHEE, WASHINGTON January 27 1947

PAY TO THE ORDER OF R. M. Wiley $ 2252.78

REGISTERED RE-7216 $2252 AND 78 CTS DOLLARS

WENATCHEE VALLEY BRANCH

SEATTLE-FIRST NATIONAL BANK

98-12/420 WENATCHEE, WASHINGTON

NORTHWEST CHEMURGY CO-OPERATIVE

BY B. L. Stockstill

15

R M Wiley

#7417

#7417

PLAINTIFF'S EXHIBIT No.

Northwest Chemurgy Co-operative
WENATCHEE, WASHINGTON

Nº 443

ACCOUNT SALES

P. R. Number

For Account of _____ Date _____

Address _____

Car Initial _____ Car No. _____ Warehouse, _____ Station

N. P. G. G. Form 7 SHAW & BOWDEN CO

WAREHOUSE RECEIPT NO.	NO. SACKS	GROSS WEIGHT	GRADE	Smut %	Dock %	TEST	No. 1 Price	Disc.	Net Price	AMOUNT

#742

NORTHWEST CHEMURGY CO-OPERATIVE JAN 27 1947 WENATCHEE, WN

Total Credit

PREPARED	CHECKED	DEBITS

Applies / Completes) CONTRACT NO.

Attached:
Expense Bill
Insp. Cer.
Weight Sheet

Advances			
Freight			
Inspection			
Smutting	lbs. @	c per ton	
Bad Order Sacks	@		
Resacking	@		
Interest			
Whse. Charges			
Total Debits			
Balance Due			

10. Findings of Fact and Conclusions of Law.
11. Judgment for Defendant.
12. Notice of Appeal.
13. Cost Bond on Appeal.
14. Designation of Record on Appeal.

on file in the above entitled cause, and that the same constitutes the record for hearing of the Appeal from the Judgment of the United States District Court for the Eastern District of Washington, in the United States Court of Appeals for the Ninth Circuit as called for by the Appellant in his designation of record on Appeal.

(Note—Item No. 3 of Plaintiff's Designation —"Answer," not included for the reason that no answer was filed, the case being tried on an Agreed Statement of Facts.)

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court at Spokane, in said District, this 8th day of November, A.D., 1950.

A. A. LaFRAMBOISE,
Clerk of Said District Court.

[Seal]: By /s/ EVA N. HARDIN,
Deputy.

[Endorsed]: No. 12733. United States Court of Appeals for the Ninth Circuit. Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a Corporation, Bankrupt, Appellant, vs. R. M. Wiley, Appellee. Transcript of Record. Appeal from the United States District Court for the Eastern District of Washington, Northern Division.

Filed November 10, 1950.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 12733

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a Corporation, Bankrupt,

Appellant,

vs.

R. M. WILEY,

Appellee.

APPELLANT'S STATEMENT OF POINTS AND DESIGNATION OF RECORD

To: A. W. Wiley and Hughes & Jeffers, his attorneys:

You and Each of You are hereby notified that

appellant's statement of points on this appeal is as follows:

I.

In determining whether a payment of money by an insolvent corporation is a preference within the meaning of Rem. Rev. Stat. of the State of Washington, § 5831-4, the intent of the parties is immaterial. The determination is made on the basis of the effect of the payment in diminishing the funds of the corporation in payment of an obligation existing prior to the date of payment.

II.

The obligation here involved arose on the date wheat was sold and delivered to Chemurgy. The preferential payment under Rem. Rev. Stat. § 5831-4 occurred ten days later when the wheat was paid for out of the account of Chemurgy by its bank.

III.

The above-described transaction was not a "cash transaction" since the seller (appellee) did not receive payment for said wheat when he sold and delivered it.

IV.

The payment out of the Bank account of Chemurgy on February 7, 1947, to appellee was a preference recoverable by appellant as Trustee in Bankruptcy under Rem. Rev. Stat. § 5831-4 and § 5831-6.

Designation of Record

Appellant hereby designates as material to the consideration of this appeal all of the record certified to the United States Court of Appeals under date of November 8, 1950, by the Clerk of the District Court from which this appeal was taken.

Dated this 17th day of November, 1950.

EGGERMAN, ROSLING & WILLIAMS,

/s/ DeWITT WILLIAMS,
Attorneys for Appellant.

Affidavit of Mailing attached.

[Endorsed]: Filed November 18, 1950.

No. 12733

United States Court of Appeals
For the Ninth Circuit

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, Bankrupt,

Appellant,

vs.

R. M. WILEY,

Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF OF APPELLANT

EGGERMAN, ROSLING & WILLIAMS,
DEWITT WILLIAMS,
Attorneys for Appellant.

918 Joseph Vance Building
Seattle 1, Washington.

THE ARGUS PRESS, SEATTLE

No. 12733

United States Court of Appeals
For the Ninth Circuit

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, Bankrupt,

Appellant,

vs.

R. M. WILEY,

Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF OF APPELLANT

EGGERMAN, ROSLING & WILLIAMS,
DEWITT WILLIAMS,
Attorneys for Appellant.

918 Joseph Vance Building
Seattle 1, Washington.

THE ARGUS PRESS, SEATTLE

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TABLE OF CASES

TEXTS AND STATUTES

United States Court of Appeals
For the Ninth Circuit

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, Bankrupt, *Appellant*, vs. R. M. WILEY, *Appellee*.	No. 12733

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF OF APPELLANT

JURISDICTION

District Court

This was a plenary action by a trustee in bankruptcy to recover on behalf of creditors of the bankrupt estate, a payment to a former creditor, which was preferential and voidable under the laws of the State of Washington, Rem. Rev. Stat. §5831-4 and §5831-6, (Complaint Tr. 3-6). The District Court had jurisdiction by virtue of Sec. 70 (e) of the Bankruptcy Act (11 U.S. C.A., §110 (e).

Circuit Court

Final decision and judgment of the District Court of the United States for the Eastern District of Washington, Northern Division was entered dismissing this action on September 29, 1950 (Tr. 23-24), and this court

has jurisdiction of this appeal from said final decision of the District Court by virtue of Title 28, U.S. Code, §1291, (28 U.S.C.A., §1291).

STATUTES INVOLVED

Appellant brought this action pursuant to Rem. Rev. Stat. of the State of Washington, §5831-4 and §5831-6 (Laws of 1941, Chap. 103) reading as follows:

> Section 5831-4.—Preferences by insolvent corporations.—Definitions. Words and terms used in this act shall be defined as follows: (a) "Receiver" means any receiver, trustee, common law assignee, or other liquidating officer of an insolvent corporation. (b) "Date of application" means the date of filing with the Clerk of the Court of the petition or other application for the appointment of a receiver, pursuant to which application such appointment is made; or in case the appointment of a receiver is lawfully made without court proceedings, then it means the date on which the receiver is designated, elected or otherwise authorized to act as such. (c) "Preference" means a judgment procured or suffered against itself by an insolvent corporation or a transfer of any of the property of such corporation, the effect of the enforcement of which judgment or transfer at the time it was procured, suffered, or made, would be to enable any one of the creditors of such corporation to obtain a greater percentage of his debt than any other creditor of the same class (L. '41, ch. 103, §1).
>
> Section 5831-6—Preference voidable when—Trust fund doctrine superseded. Any preference made or suffered within four (4) months before the date of application for the appointment of a receiver may be avoided and the property or its value re-

> covered by such receiver. No preferences made or suffered prior to such four (4) months' period may be recovered, and all provisions of law or of the trust fund doctrine permitting recovery of any preference made beyond such four (4) months' period are hereby specifically superseded (L. '41, ch. 103, §3).

As stated in *Meier v. Commercial Tire Co.,* 179 Wash. 449 at 451, 38 P.(2d) 383 at 384, the rule now found in these statutes was previously a court made rule. It was enacted into statute first in 1931 and later in 1941 in the form above quoted. The court made rule had been applied in many Washington cases since *Thompson v. Huron Lumber Co.,* 4 Wash. 600, 30 Pac. 741, that payments made by insolvent corporations must be returned upon demand by a liquidating officer.

This rule was frequently invoked by trustees in bankruptcy to recover preferential payments and illustrative cases are *Williams, as Trustee, v. Davidson,* 104 Wash. 315, 176 Pac. 334, and *Woods as Trustee, v. Metropolitan National Bank,* 126 Wash. 346, 218 Pac. 266. In the latter case the court stated:

> "The principle on which the receiver based his action would seem to be well founded in law. Ever since the case of *Thompson v. Huron Lumber Co.,* 4 Wash. 600, 30 Pac. 741, 31 Pac. 25, this court has adhered to the doctrine that an insolvent corporation may not prefer its creditors; that, although an individual creditor may do so, even to the exhaustion of his property, the right does not exist in a corporation; that its property on insolvency becomes a trust fund for the benefit of all of its creditors to be equally and ratably distributed

among them, *Conover v. Hull,* 10 Wash. 673, 39 Pac. 166, 45 Am. St. 810; *Benner v. Scandinavian American Bank,* 73 Wash. 488, 131 Pac. 1149, Ann. Cas. 1914-D 702; *Jones v. Hoquiam Lumber & Shingle Co.,* 98 Wash. 172, 167 Pac. 117; *Simpson v. Western Hardware & Metal Co.,* 97 Wash. 626, 167 Pac. 113; *Williams v. Davidson,* 104 Wash. 315, 176 Pac. 334.

"The foregoing citations announce the further rule, also, that, in an action or suit on the part of the receiver to recover as for an unlawful preference, it is not necessary that he show that the creditor, at the time of receiving the preference, had knowledge or reasonable cause to believe that the corporation was insolvent. See particularly, *Jones v. Hoquiam Lumber & Shingle Co., supra; Williams v. Davidson, supra.*

"Nor were the rights of the parties changed in respect to the right to recover the payments as an unlawful preference by the transfer of the proceedings into the bankruptcy court. By §70e of the bankruptcy act, it is provided that the Trustee in bankruptcy may avoid any transfer by the bankrupt of his property which any creditor of the bankrupt might have avoided, and may recover the property so transferred from the person to whom it was transferred. That this section gives the trustee in bankruptcy a right of action to recover property transferred in violation of state law, and is not subject to the four months' limitation of other sections (60b, 67e) of the Bankruptcy Act, was held by the Supreme Court of the United States in *Stellwagen v. Clum,* 245 U.S. 605."

OPINION BELOW

This action was one of a group brought by the Trustee in Bankruptcy of Northwest Chemurgy Cooperative against certain creditors upon identical forms of complaint to recover alleged preferential payments under the statutes of the State of Washington above referred to.

Many of these cases, including this case, are listed following *Engstrom v. DeVos,* 81 F. Supp. 854. In those cases motions to dismiss were addressed to the complaint and overruled by said opinion. An appeal was taken in one of said cases testing the ruling of the District Court in holding that the complaints stated a cause of action. Upon said appeal the District Court was affirmed by United States Court of Appeals for the Ninth Circuit (*Schneidmiller v. Engstrom,* 177 F.(2d) 196). Pursuant to stipulation contained in the appeal record in the *Schneidmiller* case judgment for the Trustee was therefor entered against all of the defendants so stipulating, the only exceptions being this case and the case against Arthur Benzel which is also now on appeal to the Court of Appeals from a judgment of dismissal. (No. 12734).

This case and the *Benzel* case were submitted on written agreed statements of facts.

The District Court concluded from the findings that the action should be dismissed and entered judgment of dismissal.

The decision of the District Court was unreported.

STATEMENT OF THE CASE

After the allegations of the complaint were held to state a cause of action in *Schneidmiller v. Engstrom,* 177 F.(2d) 196, the parties to this action entered into an Agreed Statement of Facts for submission to the court (Tr. 10-13). Paragraph I of the agreed statement in substance and effect simply restated as agreed facts Paragraphs 1 to 7 inclusive of the complaint so that it is agreed that Northwest Chemurgy Cooperative is a bankrupt, that appellant is the duly authorized and acting trustee, that at all times material the preference statutes of the State of Washington (§§ 5831-4 and 5831-6 of Rem. Rev. Stat. of the State of Washington) were in full force and effect, that Chemurgy was insolvent within the meaning of said statutes for at least four months prior to May 29, 1947 (which period includes the date of February 7, 1947 on which date the check here involved was paid out of the bank account of Chemurgy), that during all of said four months and at all times subsequent thereto there existed and now exists against said insolvent corporation and said bankrupt estate claims of general unsecured creditors upon which no payments have been made and the claims allowed and allowable are greatly in excess of the estate assets (Tr. 10-12).

The effect of said agreement on the facts was to establish beyond question that the payment here involved was a preferential payment recoverable by appellant under said Washington statutes subject only to the final point as to whether the payment to appellee here involved was a transfer of property to a creditor.

On the facts of this payment the parties by paragraph II of the agreed statement of facts, stated as follows:

> "On January 27, 1947, the defendant R. M. Wiley, a resident of Waterville, Washington, sold and delivered to Chemurgy at Wenatchee, Washington, 79,510 lbs. of wheat at $1.70 per bushel, for a total purchase price of $2252.78. At the time of said sale on said date he personally received from Chemurgy its check No. 7237, dated January 27, 1947, payable to said defendant, and drawn on the Wenatchee Valley Branch of The Seattle-First National Bank. Defendant first deposited said check for payment in the Waterville Branch of The National Bank of Commerce on February 6, 1947, and said check was paid by The Wenatchee Valley Branch of The Seattle-First National Bank out of the funds of Chemurgy then on deposit with said bank on February 7, 1947."

The agreed statement also presented a single "Question for Decision" by the trial court, reading as follows:

> "The question for decision by the court under the facts of this case is whether or not the payment of said check by the Wenatchee Valley Branch of The Seattle-First National Bank on February 7, 1947, out of the account of Chemurgy in said bank was a preference in the amount of $2252.78 within the meaning of a preference as defined in Rem. Rev. Stat. §5831-4(c)" (Tr. 13).

The court's answer to this question is found in its Conclusion of Law I (Tr. 22) reading as follows:

> "That payment of said check out of the funds of Chemurgy on deposit with the Wenatchee Valley Branch of The Seattle-First National Bank on February 7, 1947, was not such a transfer to the

defendant of the property of said insolvent Northwest Chemurgy Cooperative as to constitute an unlawful preference within the meaning of Rem. Rev. Stat. of the State of Washington, §5831-4, as the transaction was in substance and effect a cash transaction and there was no intent on the part of either party to create a debtor-creditor relationship."

SPECIFICATION OF ERRORS

1. The court erred in entering that portion of Finding of Fact III reading:

> "That the plaintiff has failed to sustain the burden of proving the transaction constitutes an unlawful preference and was other than a cash transaction" (Tr. 21).

for the reasons:

(a) That the facts stipulated prove that the payment of the check referred to in finding II on February 7, 1947, was a preference within the meaning of Rem. Rev. Stat. of the State of Washington, §5831-4, and

(b) That the transaction referred to in said Finding II was not a cash transaction and,

(c) Said finding of fact is not contained in the stipulation of facts.

2. The court erred in drawing Conclusion of Law I (Tr. 22) to the effect that payment of the check here involved out of the funds of Chemurgy on deposit with its bank on February 7th, 1947 was not such a transfer to appellee of the property of said insolvent Northwest Chemurgy Cooperative as to constitute an unlawful preference within the meaning of Rem. Rev. Stat. of

the State of Washington, § 5831-4 as the transaction was in substance and effect a cash transaction and there was no intent on the part of either party to create a debtor-creditor relationship, for the reasons:

(a) The Conclusion of Law to be drawn from the stipulated facts was that the payment on February 7th, 1947, referred to in Finding II was a preference within the meaning of Rem. Rev. Stat. §5831-4.

(b) The transaction referred to therein was not a cash transaction as held by the court.

(c) The evidence, facts and Findings of Fact do not support the statement "* * * there was no intent on the part of either party to create a debtor-creditor relationship."

(d) The intent of the parties is immaterial.

3. The court erred in entering Conclusion of Law II that defendant was entitled to have judgment dismissing the complaint for the reason:

(a) The stipulated facts and pertinent law require the entry of judgment as prayed for in the complaint.

4. The Court erred in entering judgment dismissing the complaint for the reasons:

(a) The stipulated facts require as a conclusion of law that the payment to defendant of the sum of $2252.78 on February 7, 1947, was a preference in said amount within the meaning of Rem. Rev. Stat. §5831-4(c) and was recoverable under Rem. Rev. Stat. §5831-6 by the appellant herein from the appellee.

5. The court erred in not answering the question for decision specifically presented by the agreed state-

ment of facts by holding that the payment of said check out of the bank account of Chemurgy on February 7th, 1947 was a preference in the amount of said check within the meaning of a "preference" as defined in Rem. Rev. Stat. §5831-4(c).

6. The court erred in not entering as a conclusion of law the conclusion that the payment of said check out of the funds of Chemurgy on February 7th, 1947 was a transfer to the appellee of the property of said insolvent Northwest Chemurgy Cooperative within the meaning of Rem. Rev. Stat. §5831-4 and a preference recoverable by the plaintiff from the defendant under Rem. Rev. Stat. of the State of Washington §5831-4 and 5831-6.

7. The court erred in not entering judgment as prayed for in the complaint for the reasons stated in the foregoing paragraphs 1 to 6.

ARGUMENT

The appellant's Statement of Points on Appeal are set forth on pages 33 and 34 of the transcript, and may be summarized as follows:

I.

In determining whether a payment of money by an insolvent corporation is a preference within the meaning of the Washington statutes, the intent of the parties is immaterial — the determination is made on the basis of the effect of the payment in diminishing the funds of the corporation in payment of a pre-existing obligation.

II.

The obligation here involved arose on January 27, 1947, the date on which appellee sold and delivered wheat to Chemurgy. The preferential transfer occurred ten days later when the wheat was paid for out of the account of Chemurgy by its bank.

III.

Said transaction was not a "cash transaction" since the seller (appellee) did not receive payment for said wheat when he sold and delivered it.

IV.

The payment out of the bank account of Chemurgy on February 7, 1947 to appellee for said wheat was a preference recoverable by appellant as Trustee in Bankruptcy under Rem. Rev. Stat. of the State of Washington § 5831-4 and § 5831-6.

All of the record on appeal was designated as material to the consideration of this appeal.

Since each of the points on appeal involve all, or at least portions of all, of the Specifications of Error, the case will be argued by appellant under the first three of the foregoing "Statement of Points" and each of said points will be deemed in support of each of the specifications of error. The fourth point logically follows from the first three points.

I.

In determining whether a payment of money by an insolvent corporation is a preference within the meaning of the Washington statutes, the intent of the parties is immaterial—the determination is made on the basis of the effect of the payment in diminishing the funds of the corporation in payment of a preexisting obligation.

The trial court erroneously concluded (Conclusion of Law I—Transcript 22) that there was no intent on the part of either party to create a debtor-creditor relationship. There is absolutely no statement in the agreed statement of facts from which this conclusion can even be inferred. It will be noted that the appellee waited 10 days before even depositing the check for collection during which time Chemurgy of course owed him for the wheat. As opposed to the court's conclusion which has no basis in fact is the legal relationship of debtor and creditor created by the sale and delivery of the wheat.

Preferences made within four months before the date of application for the appointment of a receiver (trustee) may be avoided and the property or its value recovered by such receiver (trustee).

"Any preference made or suffered within four

> months before the date of application for the appointment of a receiver may be avoided and the property or its value recovered by such receiver * * *" Rem. Rev. Stat. §5831-6.

It has been conclusively established that February 7, 1947, the date of the payment out of the bank account of Chemurgy to appellee was within the four-months period referred to in the above-quoted Rem. Rev. Stat. § 5831-6. *Engstrom v. DeVos,* 81 F.Supp. 854, affirmed *Schneidmiller v. Engstrom,* 177 F.(2d) 196.

The chronology of events clearly establishes a preferential payment under the Washington statute:

> January 27, 1947—Wheat sold and delivered by appellee to Chemurgy but not paid for (Finding II, Tr. 21);
>
> January 29, 1947 — commencement of the four-months period within which payments constitute preferential payments recoverable by the Trustee in Bankruptcy (this date as to this bankruptcy was authoritatively established by *Engstrom v. DeVos* and *Schneidmiller v. Engstrom, supra*);
>
> February 7, 1947—payment for said wheat by Chemurgy out of its funds on deposit in the Wenatchee Valley Branch of The Seattle-First National Bank (Finding II, Tr. 21).

Upon obtaining title as aforesaid to said wheat, Chemurgy of course became a debtor of the appellee Wiley and Wiley became a creditor of Chemurgy.

> "Whenever one person by contract or by law is liable and bound to pay another an amount of money certain or uncertain, the relation of debtor and creditor exists between them." 18 C.J. 24.

Some other definitions indicating the broad relationship of debtor and creditor are:

"One who has a right to require of another the fulfillment of a contract or obligation." *In re Putman* (D.C. Cal.) 193 F. 464, 473.

"One in whose favor an obligation exists, by reason of which he is or may become entitled to the payment of money." *Pierson v. Hickey,* 16 S.D. 46, 91 N.W. 339, 340.

"One who has the right to require the fulfillment of an obligation." *In re Wilhelm* (D.C. Md.) 25 F. Supp. 440, 443.

"One who has a right by law to demand and recover of another a sum of money on any account whatever." *Conrad v. Johnson,* 134 Kan. 120, 4 P. (2d) 767, 769.

Since a Washington statute is the basis of this action, the interpretation of such statute by the Washington court is of course controlling. A number of recent Washington cases interpreting the statute clearly demonstrate that the payment here involved was preferential and recoverable by the appellant as trustee. They hold that the intent of the parties is immaterial and the test is whether or not the estate of the bankrupt is diminished by the transfer to the creditor.

Seattle Association of Credit Men as Assignee v. P. D. Luster, 137 Wash. Dec. 181 (1950), 222 P.(2d) 843, was an action brought to recover an alleged preference under the statute here involved. The action involved three checks made payable to the defendant and paid by the insolvent's bank within the four-months period. The transaction giving rise to the payment of the checks in suit developed in the following manner: The insolvent ordered a planer from the defendant to be

shipped to a lumber company in Georgia, and sent, with its purchase order, two checks drawn on the insolvent's bank account. One check constituting the initial down payment on the planer was paid prior to the four months and not involved. The second check for the balance of the price of the planer was submitted by a memorandum stating that the check was to be held until the customer had paid for the shipment in full. This second check in the sum of $5,335.00 was paid out of the insolvent's account within the four-months period. The insolvent also ordered another saw submitting two checks, the first of which was deposited immediately upon receipt and was paid by the insolvent's bank within the four-months period and the second check was also paid within the four-months period. The Supreme Court reversed the trial court and ordered judgment for the plaintiff on all three of said checks paid within the four-months period. The Supreme Court overruled the contention of the defendant that he only intended to deal on a cash basis, stating:

> "It appears to be the contention of respondents here that North End was never an antecedent creditor of Hosmer, since, as they allege, it was the understanding of the parties that North End was to retain title to the machines until Hosmer had paid for them. The agreements between Hosmer and North End, respondents assert, amounted to no more than contracts to sell, and the sales themselves did not take place until the checks, previously delivered by Hosmer to North End were cashed. Thus, no credit was ever extended to Hosmer, and the sales were cash transactions, since

title to the machines, in respondents' view, did not pass until the time that they received their money. From this it would follow that Hosmer's estate was in no degree diminished by the cashing of the checks, and it is respondents' position that there was, consequently, no preference and that *Stern v. Lone* has no application to the present situation."

The court in overruling this contention did so in language equally applicable to such a contention by the defendant (appellee) here. The court stated:

"The essential problem, therefore, is to determine when the sales transactions were consummated. If they remained executory until North End cashed the checks, then there was no preference in either of the transactions, for North End received adequate consideration for them at that time. If, on the other hand, the sales were completed when North End received the orders and released possession of the machines, the transfers of money resulting from the subsequent cashing of the checks, amounted to payments on an antecedent debt, and must be regarded as preferences.

"In spite of the repeated insistence of respondent P. D. Luster, sole proprietor of North End, that he only intended to deal on a cash basis, it would seem that the latter is the correct view. Where the circumstances of the case indicate that a given transaction amounts to an extension of credit, it will be treated as such, regardless of whether the parties have so considered it. *Seattle Ass'n of Credit Men v. Daniels,* 15 Wn.(2d) 393, 130 P.(2d) 892. And, as Williston says:

" 'Confusion may be caused by use of the words "cash sale" or "terms cash" by business men. In

business dealings these words are frequently used when in reality a short period of credit is contemplated. In such a case it is clear that there is no cash sale in the legal sense. Under the circumstances suggested, it is not contemplated that the buyer shall refrain in the meantime from dealing with the goods or even from reselling them, and if such is the contemplation of the parties, it is impossible to say that the property was not to pass until the price was paid.' 2 Williston on Sales (Rev. Ed.) 335, §343.

* * * * *

"It is thus apparent that North End parted with all dominion and control over the machines. Substantially the only evidence tending to show that it retained the title to them consisted of Mr. Luster's statements, made after the fact of Hosmer's insolvency, that it had been his intention to retain the title. Perhaps it was. The trial judge thought so. But whatever Mr. Luster's intention may have been, it could not alter the legal effect of his actions. If it was indeed his purpose to require that he be paid for the machines prior to passage of title, he waived this requirement by permitting Hosmer to ship the machines to its own subpurchasers, sell them, and take over the proceeds, without insisting on payment in full. *Weyerhaeuser Tbr. Co. v. First Nat. Bank,* 150 Ore. 172, 38 P.(2d) 48, modified 150 Ore. 172, 43 P.(2d) 1078; *Northwest Hardware Co. v. M. & S. Logging Co.,* 132 Wash. 413, 232, Pac. 274.

"The sales having been consummated on December 23rd and December 26th, respectively, North End became a creditor of Hosmer for the obligations in question on those dates. The cashing of checks Nos. 7437, 7349, and 7350 amounted to pay-

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ments against these obligations, and, since they occurred within four months prior to Hosmer's assignment for the benefit of his creditors, must be held to have been preferential transfers within the meaning of Rem. Supp. 1941, §5831-4(c). Appellant is, therefore, entitled to avoid them."

The Washington case of *Seattle Assoc. of Credit Men v. Daniels,* 15 Wn.(2d) 393, 130 P.(2d) 892, also emphasizes that the intention of the parties as to the extension of credit is immaterial. The court there stated:

"It would seem clear that the payment made by appellant to respondents on April 10th was upon an antecedent debt. Under the express terms of the contract, the account was payable 'upon presentation of receipted bills and pay roll,' which was when 'audited and found correct to be paid in full.' The receipted bills and statement were presented, audited, and found correct on March 22nd. Payment was not then made. In other words, the account was not paid when due nor at the time the materials were furnished and the services rendered. Consequently, the respondents became general creditors of Eba's Inc. When payment was made on April 10th, it was for an antecedent debt and constituted a preference under Rem. Rev. Stat., §5831-2. *Seattle Ass'n of Credit Men v. Bank of California,* 177 Wash. 130, 30 P.(2d) 972. That the parties did not regard nor intend the transaction as an extension of credit, makes the payment nonetheless a preference. Nor does usage or custom in payment of bills make it any less so. *In re John*

Morrow & Co., 134 Fed. 686. Of a closely analogous situation, the court in that case said, p. 687:

" 'If the parties, by agreement, can treat a sale of goods on 10 days' time as a cash transaction, they may also, by agreement, treat a sale on 30 or 60 days' or longer time as a cash transaction, and practically defeat the operation of sections 57g and 60a of the bankrupt act (30 Stat. 560, 562 (U.S. Comp. St. 1901, pp. 3443, 3445)). Sections 57g and 60a of the bankrupt act do not contemplate a usage of merchants or a conventional arrangement between the parties which would enable any one of the creditors of a bankrupt to obtain a greater percentage of his debt than any other of such creditors of the same class. A sale of goods to be paid for in 10 or 30 days is not, in fact, a cash transaction, and cannot, by agreement of the parties, or a usage of merchants, be regarded as such within the meaning of the bankrupt law'." *Seattle Ass'n. of Credit Men v. Daniels,* 15 Wn.(2d) 393 at pages 397, 398.

II.

The obligation here involved arose on January 27, 1947, the date on which the appellee sold and delivered wheat to Chemurgy. The preferential payment occurred ten days later when the wheat was paid for out of the account of Chemurgy by its bank.

It has been demonstrated under Point I above that the obligation of appellee to Chemurgy arose when the wheat was sold and delivered prior to the four-months period to Chemurgy. The check itself was evidence that an indebtedness existed.

"Under the law, a check is an instrument by which a depositor seeks to withdraw funds from

> a bank. As between the drawer and the payee, it is an evidence of indebtedness. Usually a check is given for money borrowed or a debt contracted, and, in commercial transactions, as well as in law, it is equivalent to the drawer's promise to pay, and an action may be brought thereon as upon a promissory note. 1 Morse, Banks & Banking, §388. The check then in controversy in this case was an obligation on the part of H. E. Newman & Sons to pay a debt to the plaintiff, and, when payment was declined by the drawee, the plaintiff had a right of action to recover the debt of which such check was a mere evidence." *Camas Prairie State Bank v. Newman,* 15 Idaho 719, 99 Pac. 833 at page 834.

The check did not create the obligation. The obligation was created by the sale and delivery to Chemurgy. The check was the admission by Chemurgy of the existence of an obligation.

> "The giving of a check is not the creation of an obligation, but is merely the admission by the drawer of the existence of an obligation to pay a certain sum of money." *Peninsula National Bank v. Peterson Construction Co.,* 91 Wash. 621, 158 Pac. 246 at page 247.

The payment of this antecedent obligation evidenced by said check occurred when the check was paid within the four-months period.

The cashing of a check within the four-months period effects a preferential transfer which may be avoided notwithstanding that the check was delivered prior to the beginning of the four-months period, *Stern v. Lone,* 32 Wn.(2d) 785, 203 P.(2d) 1074 (quoted *infra*).

III.

Said transaction was not a "cash transaction" since the seller (appellee) did not receive payment for said wheat when he sold and delivered it.

This was not a cash sale. In a cash sale the seller "declines to transfer either title or right to possession until he is paid." 2 Williston on Sales, Revised Edition, 324, § 341. By the agreed facts title and possession passed from appellee on January 27, 1947 and he was not paid until over ten days later. There is not even an inference in the agreed facts that Chemurgy was not to deal with the wheat as its own from the moment it acquired it. Therefore the following from *Seattle Association of Credit Men v. Luster,* 137 Wn. Dec. 181, 222 P.(2d), 843, quoting Williston is relevant and applicable:

> "Under the circumstances suggested it is not contemplated that the buyer shall refrain in the meantime from dealing with the goods or even from reselling them, and if such is the contemplation of the parties, it is impossible to say that the property was not to pass until the price was paid."

The giving of the check at the time of the delivery of the wheat was of course not payment for the wheat and it in no wise affected the debt arising by reason of the sale of the wheat to Chemurgy; *Stern v. Lone,* 32 Wn.(2d) 785, 203 P.(2d) 1074, *infra; National Market Co. v. Maryland Casualty Co.,* 100 Wash. 370, 170 Pac. 1009, 174 Pac. 479 (quoted in *Stern v. Lone*); *Anderson v. National Bank of Tacoma,* 146 Wash. 520, 264 Pac. 8. The District Court therefore erred in hold-

ing that the "transaction was in substance and effect a cash transaction" (Tr. 22).

Even if the Statement of Agreed Facts had contained a statement that the parties intended a cash transaction, such intention under the circumstances, would have been immaterial. The following holding in *Seattle Association of Credit Men v. Daniels,* 15 Wn.(2d) 393, 130 P.(2d) 892, provides a complete answer to the District Court's reliance upon its unjustified conclusion that there "was no intent on the part of either party to create a debtor-creditor relationship." (Tr. 22).

> "That the parties did not regard nor intend the transaction as an extension of credit, makes the payment nonetheless a preference." *Seattle Association of Credit Men v. Daniels,* 15 Wn.(2d) 393, 130 P.(2d) 892.

As will be noted from the above quotation from *Seattle Association of Credit Men v. Luster,* the Supreme Court of Washington unqualifiedly held in *Stern v. Lone,* 32 Wn.(2d) 785 (1949), 203 P.(2d) 1074, that checks cashed within the four-months period preceding application for the appointment of receiver for the maker, effected a preferential transfer which may be avoided by the receiver notwithstanding that the checks were delivered prior to the beginning of the period. In the *Stern* case the defendant, a farmer, had delivered a considerable amount of corn to the Ingalls Packing Corporation which was delivered by Lone prior to the date four months before application was made for a receiver for Ingalls Packing Corporation. The check

was honored by Ingalls' bank within the four-months period. The defendant contended that the preference was made when the check was delivered to him and this date being prior to the four-months period the receiver could not recover the payment. The receiver contended that the preference was made when the insolvent's bank cashed the check within the four-months period. In holding for the receiver and reversing the trial court the Supreme Court stated:

"The appellant opens his argument by citing Rem. Rev. Stat. §3579 (P.P.C. §751-9), which reads as follows:

" 'A check of itself does not operate as an assignment of any part of the funds to the credit of the drawer with the bank, and the bank is not liable to the holder unless and until it accepts or certifies the check.'

"This statutory provision has been applied in numerous Washington decisions. *Lincoln County v. Gibson,* 143 Wash. 372, 255 Pac. 119; *Whorf v. Seattle Nat. Bank,* 173 Wash. 629, 634-635, 24 P.(2d) 120. It was held in *National Market Co. v. Maryland Cas. Co.,* 100 Wash. 370, 380, 170 Pac. 1009, 174 Pac. 479, an En Banc decision correcting a previous Departmental opinion in the same cause:

" 'The fundamental error in our former opinion was the holding that the indorsement and delivery of the check was the assignment of the debt, instead of its being simply and only what the negotiable instruments law provides it shall be. The ordinary bank check is not, either in law or in equity, an assignment of the fund upon which it is drawn (Rem. Code, § 3579), but is purely and

simply an order for the payment of money, which in nowise affects the debt for which it is given until the order is paid; and being dishonored, leaves the drawer still indebted to the payee, the same in all respects as though the check had never been drawn and delivered. Moreover, such a check is revocable by the drawer at any time before it is paid. *Peoples' Sav. Bank & Trust Co. v. Lacey,* 146 Ala. 688, 40 South 346; *Pease & Dwyer v. State Nat. Bank,* 114 Tenn. 693, 88 S.W. 172; *Kaesemeyer v. Smith,* 22 Idaho 1, 123 Pac. 943; Ann. Cas. 1914C 665, 43 L.R.A.(N.S.) 100.'

"Later, in the case of *Anderson v. National Bank of Tacoma,* 146 Wash. 520, 525, 264 Pac. 8, it was said by this court:

" 'We have accordingly many times held that the ordinary bank check is not, either in law or equity, an assignment of the funds upon which it is drawn (§ 3579 supra), but is purely and simply an order for the payment of money which in nowise affects the debt for which it is given until the order is paid. *National Market Co. v. Maryland Casualty Co.,* 100 Wash. 370, 170 Pac. 1009, 174 Pac. 479, 1 A.L.R. 450.' * * *

"We are, of course, not here concerned with what constitutes payment with respect to the statute of frauds, nor are we primarily concerned with the date when Lone received 'payment' for his corn. Our statutory definition of 'preference,' quoted earlier in this opinion, contemplates two kinds of preferences: (1) suffering a judgment, and (2) a *transfer* of any of the property of the corporation. No judgment is involved in this case. We are primarily concerned here with whether or not the property of the corporation was diminished

by a transfer of corporate property to Lone, and if so, was the transfer made more than four months before May 9, 1947, or within that four months? In deciding the question before us, the word 'transfer' is the key word, not 'payment.'

"The provisions of the Federal bankruptcy act are so similar to those of our insolvent corporations act (Laws of 1941, chapter 103) that there are many decisions of the Federal courts which are in point. We will, however, in an effort to attain reasonable brevity, refer to them only incidentally. In the opinion in *Continental Trust Co. v. Chicago Title & Trust Co.,* 229 U.S. 435, 443, 57 L.ed. 1268, 33 S.Ct. 829, the supreme court of the United States said:

" 'To constitute a preferential transfer within the meaning of the Bankruptcy Act there must be a parting with the bankrupt's property for the benefit of the creditor and a consequent diminution of the bankrupt's estate.'

"In 4A Remington on Bankruptcy (5th ed.) 265, § 1713, discussing 'Voidable Preferences,' the author says:

" 'Unless property is actually transferred to a creditor, there can be no diminution of the estate.'

"That is also true under our statute on insolvent corporations.

"It seems clear to us that no transfer of property was made by the delivery of the check to Lone on some day during the last week of 1946. It follows that the corporation's property was in no way diminished when the check was delivered to Lone, since he then received no property of the corporation, other than a piece of paper, by means of which he could in the future secure some of the

corporation's money, if the corporation did not in the meantime stop payment of the check and there was still sufficient of the corporation's money remaining on deposit in the bank to honor the check at the time it was presented. As it happened, there was, and it did honor the check on January 25, 1946, and Lone at once received the money through the Kent bank. It was when the check was cashed that corporate assets were transferred and a preference made. That was late in January, 1947, and within four months before May 9, 1947, the date of the application for the appointment of a receiver, and therefore a preference, which could be avoided and a recovery had from Lone by the receiver, under the Laws of 1941, Chapter 103, § 3, p. 272, Rem. Supp. 1941 § 5831-6. * * *

"For the foregoing reasons, we are of the opinion that the corporation's estate was diminished when the check was cashed, not when it was delivered; that is to say, the diminution occurred late in January, 1947, and well within the four months prior to the appellant's application for a receiver on May 9, 1947. It follows that the judgment appealed from must be reversed, and that will be the ruling of this court.

"It is further ordered that the existing judgment be set aside and a new judgment entered in accordance with the prayer of the complaint and consistent with this opinion."

Unless the creditor holds a security all inquiry regarding the status of a preference is limited to what took place within the four-months period.

In the case of *Seattle Assoc. of Credit Men v. Hudson Machinery Company,* 135 Wash. Dec. 643 (1950),

214 P.(2d) 681, the defendant had sold to the insolvent a motor prior to the four-months period and received payment one day within the four-months period. The defendant there contended that it had not received a preference because

> "* * * of the nature of this transaction, whereby the payment made by the insolvent was balanced by funds or property supplied by the creditor, respondent is in a different class than other unsecured creditors."

The Supreme Court in overruling this contention and reversing the trial court and ordering judgment for the receiver stated:

> "The answer is no. Respondent does not claim any priority by reason of the various statutes creating liens or otherwise establishing priority of debts. (See, for example, Rem. Rev. Stat. §§1129, 1131-4, 1132, 1141, 1149, 1154, 1156, 7682, 11260.) Respondent was not entitled to a greater percentage because of any security it held, for it held none. It is this fact which distinguishes the instant case from the cases cited by respondent (citing cases).
>
> "Respondent was not entitled to a greater percentage because of credit extended to the insolvent in connection with the sale of the motor, whether or not the motor was resold at a profit, for the state preference act expressly limits any setoff to credit or credits given wholly within the four months' period. * * *
>
> "Since respondent, as a *claimant* against the estate of the insolvent, would not have been entitled to a greater percentage of its claim than any other unsecured creditor, then, under the test referred to above, it was in the same class with

them. The payment in question was accordingly a preference. Since the preference was extended within the four months' period, it was voidable and recoverable in this action. Rem. Supp. 1941, § 5831-6.

"Respondent, in its argument, has emphasized the fact that the motor was resold at a profit. To the extent that this is intended to show that respondent is in a different class than other unsecured creditors, it is answered by what has been said above. On the other hand, if it is contended that this circumstance shows that the payment in question did not diminish the insolvent's estate, and so was not a transfer of property within the meaning of the act, such contention is negatived by the express term of Rem. Supp. 1941, § 5831-7, quoted above.

"Whatever may have been the law prior to the enactment of the state preference act in 1941, the legislature has now provided, with respect to preference payments made in discharge of unsecured credits, a definite cut off date, represented by the beginning of the four months' period. There may be inquiry beyond that date with respect to any claim that a preference represents payment of a credit which has priority or lien protection under statute, or which is secured by agreement of the parties. But absent such a claim, all inquiry regarding the status of a preference is limited to what took place within the four months' period. Thus secured or unsecured credits received by the insolvent from the creditor within four months' period may be set off against the preference, whether or not the insolvent made a profit on the transaction. But credits received by the insolvent

from the creditor prior to the four months' period, unless enjoying statutory priority or secured in some manner, may not be set off or taken into consideration in any other way, whether or not the insolvent made a profit on the transaction.

"For the same reason, that is, that the cut off date provided in Rem. Supp. 1941, §5831-7, is now controlling as to the type of transaction in question, respondent's other contentions to the effect that the sale of the motor and the payment were made 'contemporaneous'; that the payment was made 'in the ordinary course of business'; and that the payment was made in connection with a transaction the 'net result' of which was to increase the value of the estate, are inapposite, assuming that they are meritorious in other respects."

Even if the District Court intended by its conclusion that the transaction was a cash transaction in the "popular sense" because a check was given, such conclusion would not sustain a finding that the ultimate payment of the check was not a statutory "preference." The determining point is that the funds of the insolvent corporation were diminished within the four-months period (by payment out of its bank account) for a debt created prior to the four-months period. This is emphasized in the following quotation from *Stern v. Lone,* 32 Wn.(2d) 783, 203 P.(2d) 1074, the court stating:

"We are, of course, not here concerned with what constitutes payment with respect to the statute of frauds, nor are we primarily concerned with the date when Lone received 'payment' for his corn. Our statutory definition of 'preference'

No. 12733

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For the Ninth Circuit

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vs.

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Appellee.

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Brief of Appellee

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APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF OF APPELLEE

STATEMENT OF THE CASE

The appellant's statement of the case is factually correct; however, appellee does controvert and deny that the agreed statement of facts establishes anything other than that the transaction as between the parties was a cash transaction.

SUMMARY OF ARGUMENT

Appellee Contends:

I.

To determine that a payment of money by an insolvent corporation, (within the four-month period preceding the filing of the petition in bankruptcy), is a preference within the meaning of the Washington statutes, the court must first find that the payment was on a pre-existing debt incurred prior to the

beginning of the four-month period and not paid as a condition precedent to acquiring title to property of equal value.

II.

The transaction here involved was a cash sale of wheat on January 27, 1947, appellee receiving from appellant a check in payment of the purchase price (Transcript, 29) and Account Sales marked paid on that date (Transcript, 30).

III.

That the check given appellee by appellant on January 27, 1947, constituted only conditional payment, and title to the wheat did not pass as between the parties until February 7, 1947, on which date the check was paid by drawee bank.

That had the check given appellee by appellant not been paid when presented on February 7, 1947, appellee would have been entitled to rescind the transaction and reclaim his wheat.

ARGUMENT

I.

To determine that a payment of money by an insolvent corporation (within the four-month period preceding the filing of the petition in bankruptcy) is a preference within the meaning of the Washington Statutes, the court must first find that the payment was on a pre-existing debt incurred prior to the beginning of the four-month period and not paid as a condition precedent to acquiring title to property of equal value.

The argument set forth in appellant's brief is predicated entirely on the false assumption that the

transaction between the parties on January 27, 1947, was a sale on credit and that title unconditionally passed, as between the parties, on the date appellee delivered the wheat to appellant and accepted from appellant a check in payment.

After careful study of all the authorities and cases cited by appellant's counsel, we have been unable to find even one in point. Without exception the decisions pertain to payments made on pre-existing debts.

In the interest of brevity, we will refrain from further comment on appellant's argument.

* * * * *

The third element of a "preference" is that the creditor's claim must have been a pre-existing debt. In *Remington on Bankruptcy (4th Ed.)* § 1694, the author states:

> " * * and the transfer will not amount to a preference if made contemporaneously with (or before) the rising of the claim. Preference implies preceding credit."

In § 1674 the author further states:

> "Where a seller has the right to rescind the sale and recover the goods, such right being predicated upon the failure of the title to pass for lack of meeting of minds, a return of such goods will not constitute a preference; for the seller thereby is declared never to have parted with his ownership, nor have become a creditor for the goods, and the title to them is not in the bankrupt."

and in § 1695 states:

> "Cash transactions, not preferences. Abso-

lute simultaniety is not requisite, if the title is not meant to pass until the payment is actually made."

II.

The transaction here involved was a cash sale of wheat on January 27, 1947, Appellee receiving from Appellant a check in payment of the purchase price (Transcript, 29) and account sales marked paid on that date (Transcript, 30).

The record clearly shows that on January 27, 1947, appellee delivered to appellant wheat having a market value of $2,252.78 and accepted appellant's check in that amount for the purchase price. (Transcript, 12.)

There is not even an inference in the record that the parties, or either of them, ever considered the transaction as anything other than a cash transaction.

The District Court found that the appellant (plaintiff) failed to sustain the burden of proving that the transaction constituted an unlawful preference and was other than a *cash* transaction (Transcript, 21), and concluded, as a matter of law, that the transaction was in substance and effect a *cash transaction* and there was no intent on the part of either party to create a debtor - creditor relationship. (Transcript, 22.)

Courts must of necessity determine the character of a transaction by the circumstances of the case, and where the circumstances indicate that a given transaction amounts to a *cash sale*, it should be

treated as such.

It is a matter of common knowledge that at no time during the past five years has any wheat farmer been obliged to extend credit in order to dispose of his wheat at the market price, and it must be conceded that this transaction was at the market price, there being nothing in the record and no contention made by appellant to the contrary.

There is not even an inference in the record that appellee ever intended or agreed to extend any credit or terms to appellant; to hold the check for any given period; or to transfer any title in the wheat to appellant, other than conditionally subject to the payment of the check when presented to the drawee bank.

III.

That the check given Appellee by Appellant on January 27, 1947, constituted only conditional payment, and title to the wheat did not pass as between the parties until February 7, 1947, on which date the check was paid by drawee bank.

That had the check given Appellee by Appellant not been paid when presented on February 7, 1947, Appellee would have been entitled to rescind the transaction and reclaim his wheat.

The courts are in accord that where a check, or its equivalent, is given in payment of the purchase price in a cash transaction, and especially when the use of checks is the accepted method of consummating such cash transactions, the check constitutes only conditional payment, and until the check is paid, the title, as between the parties, passes only conditionally;

and, upon dishonor of the check, the seller may rescind the transaction and reclaim that with which he has parted.

One of the leading cases on this point is the case of *Standard Investment Co. vs. Town of Snow Hill, N. C.*, 78 Fed. (2d) 33. Briefly, the facts were that Standard Investment Co. filed suit again the Town of Snow Hill and the receiver of the failed National Bank of Snow Hill. N. C. to recover certain bonds pledged by the bank as security for the deposit of the town, or in lieu, to have a preferred claim for the amount of the bonds against the assets of the bank. Plaintiff's agent had accepted a check from the bank in payment for the bonds at time of delivery. The bank immediately delivered the bonds to the mayor of the Town of Snow Hill as security for the town's deposit in the bank. The check issued by the bank was drawn on a foreign bank and when plaintiff presented check for payment, drawee bank refused because the Bank of Snow Hill had closed the day the check was presented. In its decision the court held that Standard Investment Co. was entitled to recover from the Town of Snow Hill and in the opinion stated as follows:

> "There can be no question, we think, but that the title of the bank was defective. The sale was a cash transaction, in which the passage of title depended upon payment; and it is well settled that, in the absence of special agreement to the contrary, a check is conditional payment only

> and does not operate to effect payment unless it is itself paid. The rule that a check of a debtor is merely conditional payment applies to obligations arising out of debts; and, where there is a sale for cash on delivery and payment is made by check of the buyer, such check constitutes only conditional payment. Until the check is itself paid, the title, as between the parties, passes only conditionally; and upon dishonor of the check, the seller may rescind the transaction and reclaim that with which he has parted."

This principle has been followed and adopted by the Supreme Court of the State of Washington. In the case of *Quality Shingle Co. vs. Old Oregon Lumber & Shingle Co.*, 110 Wash. 60; 187 Pac. 705, the facts were that plaintiff owned a carload of shingles which it delivered to the Great Northern Railway Co. in the State of Washington for shipment to Whitefish, Montana. The Railway Company delivered to plaintiff a straight non-negotiable bill of lading, wherein plaintiff was named both as consignor and as consignee. Plaintiff subsequently sold the carload of shingles to Shepard-Traill Co. on the basis of the purchase price being paid upon delivery of the bill of lading. Plaintiff thereupon delivered the bill of lading, endorsed in blank to Shepard-Traill Co. and received that company's check for the amount of the agreed purchase price. Plaintiff presented the check to drawee bank in due course and payment was refused. In the meantime, Shepard-Traill had sold the carload of shingles to Old Oregon Lumber &

Shingle Co. for value and delivered to said company the bill of lading endorsed in blank.

In ruling that the plaintiff was entitled to recover the amount of the purchase price from the Old Oregon Lumber & Shingle Co. the court in its opinion, at *page 64*, stated:

> "It seems to us to follow, in the light of elementary rules of law, that, as between respondent and Shephard-Traill Co., the title to the shingles did not pass from respondent (Quality Shingle Co.) to Shepard-Traill Co. upon it receiving the bill of lading for the shingles and giving its check to respondent therefor. The real question in this case is whether or not respondent retained such equitable right in the shingles that it may successfully assert such right as against appellant (Old Oregon Lumber & Shingle Co.), the purchaser of the shingles from Shepard-Traill."

The court concluded that Quality Shingle Co. had the same right to the shingles as against appellant as it had as against Shepard-Traill Co., because it was an interstate commerce shipment.

In the case of *In re Perpall*, 256 Fed. 758, the facts were briefly that the seller delivered a bond by messenger to a stock broker as a cash sale. The messenger left the bond with the purchasing broker, as was the business custom, to permit the broker to make necessary book entries, prepare check for payment, etc. Another messenger called at the broker's office, later the same day, and picked up the check in payment of the purchase price for the bond. Later, the

same day, an involuntary petition in bankruptcy was filed against the stock broker and upon seller presenting check to drawee bank for payment, payment was refused. In deciding that the seller was entitled to recover the bond or its value, the court stated as follows:

> "In the case of Empire State Type Founding Co. vs. Grant, 114 N. Y. 40, 21 N. E. 40, it was held that, where a contract for the sale of personal property does not provide, in express terms, that payment shall be made on delivery, or that payment and delivery shall not be concurrent, the intent of the parties must control, and if from the acts of parties and the surrounding circumstances it can be inferred that it was intended that payment and delivery should be concurrent acts, the title will be deemed to have remained in the vendor until the condition of payment is complied with. The court in that case also concluded that the question of intent in such case is one of fact.
>
> "Upon the facts now under consideration, the referee, before whom the testimony was taken, has found that the sale of the bond in question was for cash or the equivalent of cash upon delivery; in other words, it has been resolved as a question of fact that before title to the bond should pass to the bankrupt there was the necessity of the performance by him of the condition precedent to payment. We believe this finding of the referee to be entirely justified by the evidence."

Later, in *In re Perpall*, 271 Fed. 466, in which case the facts were very similar to those in the above cited case involving the same bankrupt, the check given by the bankrupt in payment of the purchase

price of securities on a cash sale was paid by the drawee bank when presented. The action was brought by the trustee to recover the amount paid on the check as a preference. The court held that title in such a transaction did not pass until the check was paid and denied the trustee was entitled to recover. In the decision the court cited *In re Perpall*, 256 Fed. 219, as an authority.

The two decisions in the *Perpall Cases* are later cited as authoritative in the case of *Hough vs. Atchison, T. & S. F. Ry. Co.*, 34 Fed. (2d) 238.

In the case of *Manly vs. Ohio Shoe Co.*, 25 Fed. (2d) 384, the court held that where a bankrupt secures possession of goods by giving a worthless check, the recovery of the goods does not constitute a preference.

Again in the case of *Marion Machine Foundry & Supply Co. vs. Giraud*, 285 Fed. 160, in which case the petitioner sold the bankrupt merchandise (rig irons) and accepted a check in payment; the drawee bank refused payment when presented; three days later the petition filed in bankruptcy; and the merchandise subsequently sold by the receiver; the court held:

> "It is not necessary to show actual fraud. It is sufficient if in equity and good conscience the proceeds of the sale of the rig irons ought to be paid over to the petitioner. The case is not affected by the fact that petitioner accepted a check which was not paid."

In the above case, *In re Perpall*, 256 Fed. 758, was again cited as an authority.

CONCLUSION

For the sake of brevity we have refrained from citing the numerous decisions and references set forth in the authorities and cases herein cited.

We feel justified in contending that the question here before the court has been so definitely settled, for such a long period of time, that to contend to the contrary is to no avail.

If the law pertaining to such transactions was as contended by appellant, it would be virtually impossible to transact business with corporations in the usual and accepted manner. To contend that a seller cannot consummate a *cash transaction* if he accepts a check in payment for his goods *unless he cashes the check at the buyer's bank the same day he delivers the goods;* or to contend that a seller who accepts a check in payment on delivery of goods, and presents the same and receives payment from the drawee bank within a reasonable time after the transaction occurs, has extended credit to the buyer under the intent and meaning of the Federal bankruptcy laws, or the statutes of the State of Washington, appear to us to be contentions which are totally unsupported by any rule of law, equity or common sense.

The very statute (Rem. Rev. Stat. of the State of Washington, § 5831) upon which the appellant relies

was enacted to clarify the question of what payments received by creditors of a corporation on pre-existing debts were preferences, without the receiver or trustee carrying the burden of any proof as to insolvency, and the legislature never intended, by enacting said statute, in any way to change or modify the well established principles of law pertaining to cash transactions.

In the case at bar the bankrupt corporation did not acquire title to appellee's wheat until February 7, 1947, on which date appellee received payment of the purchase price from appellant's bank. The payment of appellant's check by the drawee bank on February 7, 1947, did not diminish the assets of the bankrupt, as the bankrupt at that time acquired title to the appellee's wheat, which was of equal or greater value than the amount paid on the check. Such is not a preference.

Appellee submits that the judgment of the District Court should be affirmed.

Respectfully submitted,

HUGHES & JEFFERS
By JOSEPH L. HUGHES
Attorneys for Appellee

No. 12734

United States
Court of Appeals
for the Ninth Circuit.

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a Corporation, Bankrupt,

Appellant.

vs.

ARTHUR BENZEL.

Appellee.

Transcript of Record

**Appeal from the United States District Court,
Eastern District of Washington,
Northern Division.**

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS OF RECORD

Attorneys for Plaintiff and Appellant:

EGGERMAN, ROSLING & WILLIAMS,
918 Joseph Vance Bldg.,
Seattle 1, Washington.

Attorneys for Defendant and Appellee:

W. WALTERS MILLER,
Ritzville State Bank Bldg.,
Ritzville, Washington.

HUGHES & JEFFERS,
501 Doneen Bldg.,
Wenatchee, Washington.

In the United States District Court for the Eastern District of Washington, Northern Division

No. 745—In Bankruptcy

COMPLAINT

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a Corporation, Bankrupt,

Plaintiff,

vs.

ARTHUR BENZEL,

Defendant.

Plaintiff alleges as follows:

1. The action arises under Section 70 of the Act of Congress relating to Bankruptcy (U.S.C. Title 11, Chapter 7, Sec. 110), as hereinafter more fully appears.

2. At all times herein mentioned Northwest Chemurgy Cooperative was and is now a Washington corporation hereinafter sometimes referred to as "Chemurgy."

3. On May 29, 1947, Chemurgy duly filed a Petition for an Arrangement under Chapter XI of the Act of Congress relating to Bankruptcy in the United States District Court for the Western District of Washington, Northern Division, Cause No. 37569. On said date said Court entered an order accepting and approving Chemurgy's Petition for an Arrangement as properly filed under Chapter XI of said Act.

4. Chemurgy was unable to consummate the proposed Arrangement and upon a hearing duly noticed and held pursuant to Section 376 (2) of the Act of Congress relating to Bankruptcy, said Court on December 13, 1947, duly made and entered its order that Chemurgy is a Bankrupt under said Act and that Bankruptcy be proceeded with pursuant to the provisions of said Act.

5. Subsequent to said order determining Chemurgy a Bankrupt, after proceedings duly had therefore, plaintiff on January 6, 1948, was by the order of said Court duly appointed Trustee of the estate of said Bankrupt and thereafter on said January 6, 1948, plaintiff duly qualified as Trustee of said estate and since said date at all times has been the duly appointed, qualified and acting Trustee of the estate of said Bankrupt.

6. At all times herein mentioned Sections 5831-4 and 5831-6 of Remington's Revised Statutes of the State of Washington (Laws of 1941, Ch. 103), Secs. 1 and 3 were in full force and effect. Said statutes provide as follows:

"5831-4, Preference by insolvent corporations—Definition. Words and terms used in this act shall be defined as follows: (a)'Receiver' means any receiver, trustee, common law assignee, or other liquidating officer of an insolvent corporation. (b) 'Date of application' means the date of filing with the Clerk of the Court of the petition or other application for the appointment of a receiver, pursuant to which application such appointment is

made, or in case the appointment of a receiver is lawfully made without court proceedings, then it means the date on which the receiver is designated, elected or otherwise authorized to act as such. (c) 'Preference' means a judgment procured or suffered against itself by an insolvent corporation or a transfer of any of the property of such corporation, the effect of the enforcement of which judgment or transfer at the time it was procured, suffered, or made, would be to enable any one of the creditors of such corporation to obtain a greater percentage of his debt than any other creditor of the same class. L. '41, ch. 103, Sec. 1."

"5831-6, Preference voidable when—Trust fund doctrine superseded. Any preference made or suffered within four (4) months before the date of application for the appointment of a receiver may be avoided and the property or its value recovered by such receiver. No preferences made or suffered prior to such four (4) months' period may be recovered, and all provisions of law or of the trust fund doctrine permitting recovery of any preference made beyond such four (4) months' period are hereby specifically superseded. L. '41, ch. 103, Sec. 4."

7. For at least four (4) months immediately prior to May 29, 1947, Chemurgy was unable to pay its debts in the ordinary course of business and was insolvent within the meaning of said statutes of the State of Washington.

8. Within said four months' period Chemurgy being insolvent paid to the defendant above named

a total of $1,627.50 upon an antecedent debt or debts then past due and owing by Chemurgy to said defendant upon which defendant is entitled to an offset of $ None for credit given within said four months' period.

9. The effect of such payment is to enable the said defendant to obtain a greater percentage of the indebtedness due to said defendant than other creditors of the same class.

Wherefore, plaintiff prays for judgment against the defendant in the sum of $1,627.50 with interest and with costs taxes in favor of the plaintiff and against the defendant.

EGGERMAN, ROSLING & WILLIAMS,

/s/ DeWITT WILLIAMS,
Attorneys for Plaintiff.

[Endorsed]: Filed May 28, 1948.

District Court of the United States for the Eastern District of Washington, Northern Division

Civil Action File No. 745

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a Corporation, Bankrupt,

Plaintiff,

vs.

ARTHUR BENZEL,

Defendant.

SUMMONS IN A CIVIL ACTION

To the above-named Defendant: Arthur Benzel.

You are hereby summoned and required to serve upon Eggerman, Rosling & Williams, plaintiff's attorneys, whose address is 918 Joseph Vance Building, Seattle 1, Washington, an answer to the complaint which is herewith served upon you, within twenty days after service of this summons upon you, exclusive of the day of service. If you fail to do so, judgment by default will be taken against you for the relief demanded in the complaint.

A. A. LaFRAMBOISE,
Clerk of Court.

[Seal] By /s/ EVA M. HARDIN,
Deputy Clerk.

Date: May 28, 1948.

Return on service of writ attached.

[Endorsed]: Filed June 5, 1948.

[Title of District Court and Cause.]

MOTION TO DISMISS

Comes Now the defendant, Arthur Benzel, by his attorneys, Hughes & Jeffers and Sam R. Sumner, Sr., and respectfully moves the Court for the entry herein of an order dismissing the above-entitled action, upon the ground that the plaintiff's com-

plaint herein fails to state a claim upon which relief may be granted.

In support of this motion there is hereto attached statement of the reasons upon which defendant bases this motion.

Dated this 17th day of August, 1948.

HUGHES & JEFFERS,

By /s/ JOSEPH L. HUGHES,

/s/ SAM R. SUMNER, SR.,

Attorneys for Defendant.

Statement of Reasons Why the Foregoing Motion for Dismissal Should Be Granted

In this action plaintiff seeks to recover moneys paid to the defendant by plaintiff corporation during the period from January 29, 1947, to May 29, 1947, on the grounds that such payments were preferences and voidable under the provisions of §§ 5831-4 and 5831-6 of Remington Revised Statutes of the State of Washington (Laws of 1941, Ch. 103).

It is defendant's contention that § 5831-5 of Remington's Revised Statutes of the State of Washington (Laws of 1941, Ch. 103, Sec. 2) was in full force and effect at all times mentioned in plaintiff's complaint. That said section provides as follows:

> "§ 5831-5—Action to Recover—Limitation. If not otherwise limited by law, actions in the court of this State by a receiver to recover preferences may be commenced at any time within, but not after, six (6) months from the

date of application for the appointment of such receiver."

That the trustee, who is relying on the provisions of § 5831 Remington Revised Statutes of Washington as authority for his right to recover in this proceeding, is required to accept all conditions of the statute, which grants the existence of his right to recover. (Dugger vs. Hamilton National Bank, 29 Fed. Supp. 1021.) In the case at bar the date of application for the appointment of such receiver, as contemplated by the statute, was the 29th day of May, 1947, on which date the Northwest Chemurgy Cooperative, a corporation, filed its petition for an arrangement under Chapter XI of the Act of Congress relating to bankruptcy in the U. S. District Court for the Western District of Washington, Northern Division, Cause No. 37569 (Tit. 11, § 378 (2)). Consequently, the right granted the trustee under the State statute to recover preferential payments terminated on November 29, 1947.

[Endorse]: Filed August 19, 1948.

[Title of District Court and Cause.]

ORDER DENYING MOTION TO DISMISS

The Motion of the defendant to dismiss this action came on regularly for hearing before the undersigned Judge of the above-entitled Court on August 23rd, 1948, the parties being represented in court by their attorneys of record herein. The

Court heard the argument of counsel and thereafter considered the briefs filed on behalf of the parties. On January 5th, 1948, the Court made and filed his opinion herein denying said motion.

Now, Therefore, in accordance with said opinion and ruling and pursuant thereto, it is hereby ordered that defendant's said motion to dismiss be and the same is hereby denied. The exception of the defendant is noted.

Done in Open Court this 27th day of January, 1949.

/s/ SAM M. DRIVER,
Judge.

Presented by:

/s/ DeWITT WILLIAMS,
Of Attorneys for Plaintiff.

Approved as to Form for Entry:

/s/ HUGHES & JEFFERS,
Attorneys for Defendant.

[Endorsed]: Filed January 27, 1949.

[Title of District Court and Cause.]

AGREED STATEMENT OF FACTS

It Is Agreed by and between the above-named plaintiff and defendant that this action may be tried to the court upon the following agreed statement of facts:

I.

At all times herein mentioned Northwest Chem-

urgy Cooperative was and is now a Washington corporation, hereeinafter referred to as Chemurgy. On May 29, 1947, Chemurgy duly filed a petition for an arrangement under Chapter XI of the Act of Congress relating to Bankruptcy in the United States District Court for the Western District of Washington, Northern Division, Cause No. 37569. On said date said court entered an order accepting and approving Chemurgy's petition for an arrangement as properly filed under Chapter XI of said Act. Chemurgy was unable to consummate the proposed arrangement and upon a hearing duly noticed and held pursuant to Section 376 (2) of the Act of Congress relating to bankruptcy, said Court on December 13, 1947, duly made and entered its order that Chemurgy is a bankrupt under said Act and that bankruptcy be proceeded with pursuant to the provisions of said Act. Subsequent to said order determining Chemurgy a bankrupt after proceedings duly had therefor, plaintiff, on January 6th, 1948, was by the order of said Court duly appointed Trustee of the estate of said bankrupt and thereafter on said January 6, 1948, plaintiff duly qualified as Trustee of said estate and since said date at all times has been the duly appointed, qualified and acting Trustee of the estate of said bankrupt. At all times herein material Sections 5831-4 and 5831-6 of Rem. Rev. Stat. of the State of Washington (Laws of 1941, Chap. 103, Sections 1 and 3) were in full force and effect. For at least four months immediately prior to May 29, 1947, Chemurgy was unable to pay its debts in the ordinary

course of business and was insolvent within the meaning of said statutes of the State of Washington.

During all of said four months and at the present time there existed and now exists against said insolvent corporation and said bankrupt estate claims of general unsecured creditors on file with said court in said bankruptcy proceeding, upon which claims from the inception thereof as debts of the corporation no payment has been made. The claims allowed and allowable are greatly in excess of the estate assets.

II.

That on the 3rd day of January, 1947, the defendant, Benzel, a shareholder of Chemurgy residing at Ralston, Washington, upon learning that Chemurgy desired to purchase wheat from its shareholders telephoned from the Centennial Flouring Mill office in Ralston, Washington, to Mr. R. D. Whitemore at Wenatchee, Washington, to discuss with Whitemore, who was an employee of Chemurgy, authorized to purchase wheat on its behalf, the matter of selling one thousand (1000) bushels of wheat owned by Benzel to Chemurgy, which wheat was then located at Ralston, Washington, in the warehouse of Centennial Flouring Mills. Whitemore stated that he desired to buy said wheat on behalf of Chemurgy, and thereafter on said date negotiations were carried on by Ralph Snyder of the Centennial Flouring Mills Company on behalf of Benzel. Snyder informed Whitemore that a negotiable warehouse receipt had been issued for said wheat, and Whitemore requested that such receipt be endorsed and forwarded to him via mail

upon said date and that upon receipt thereof a check for the purchase price of said wheat would be mailed to Benzel.

If called as a witness, Snyder would testify as follows: That he, Snyder, then informed Whitemore that he had no authority to sell said wheat except for cash and that Whitemore thereupon informed Snyder that the sale would be a cash sale and during said conversation promised that the check of Northwest Chemurgy would be mailed January 3, 1947, in the sum of $1,627.50, directed to Benzel, and that in order to effect a cash sale Snyder would be required to mail warehouse receipt No. S6035 for 1,000 bushels of turkey red wheat to Chemurgy on said date. On the other hand, Whitemore, if called as a witness, would deny the foregoing statement of Snyder and would himself testify instead that he told Snyder to mail said warehouse receipt to him and that he would, immediately upon receipt thereof, mail a Chemurgy check in payment of said wheat, and that Snyder agreed to this procedure.

Said receipt, properly endorsed, was mailed to Chemurgy by Snyder pursuant to Whitemore's request, by letter, a copy of which is attached hereto as Exhibit A. Chemurgy failed on January 3, 1947, to mail a check in the sum of $1,627.50 to Benzel and no further action was taken by or on behalf of Chemurgy with respect to said sale until January 13, 1947, at which time it drew its check for said wheat payable to Benzel, being check No. 7090 dated January 13, 1947, drawn on the Wenatchee Valley Branch of the Seattle-First National Bank, Wenatchee, Washington, in the sum of

$1,627.50, which Benzel received on the 14th day of January, 1947, together with a statement from Chemurgy with respect to said wheat, entitled "Account Sales, No. 427, dated January 13, 1947," containing the following items:

For Account of Arthur Benzel; Address, Ritzville, Washington; dated January 13, 1947; Warehouse Receipt No. 6035; No. sacks "B;" Gross weight 6000; Grade, No. 1 H. W.; Test, 60; Net price, $1.70 per bushel:

Total Amount		$1700.00
Less handling charge	$37.50	
Less ins. and storage	35.00	
Total debits	$72.50	
Balance Due		$1627.50

The price of wheat f.o.b. Ralston of the grade here involved was $1.70 per bushel on January 3, 1947, and $1.71 per bushel on January 13, 1947.

III.

On January 18, 1947, Benzel first deposited said check No. 7090, dated January 13, 1947, for collection in the Ritzville Branch of the Old National Bank. Said bank presented the check for collection to the Wenatchee Valley Branch, Seattle-First National Bank but said check was returned to the Ritzville Branch, Old National Bank, by said Wenatchee Valley Branch, Seattle-First National Bank, because there were no funds on deposit in said Wenatchee Valley Branch, Seattle-First National

Bank, to pay said check. Said check was returned to Benzel prior to January 22, 1947, and Benzel was informed by the said Old National Bank that said check had not been paid because of insufficient funds, and Benzel then contacted Whitemore and was advised by Whitemore that the check issued was returned by the Wenatchee Valley Branch of the Seattle-First National Bank in error and requested that the check be redeposited, a copy of which letter dated January 22, 1947, marked Exhibit "B," is hereunto attached and made a part of this paragraph. Said check was then by Benzel redeposited and was received from the Ritzville Branch of the Old National Bank by the Wenatchee Valley Branch of Seattle-First National Bank on January 27, 1947, but was not then paid because the Chemurgy account with said bank was then overdrawn and remained overdrawn until February 3, 1947, at which time the check was paid out of the account of Chemurgy with said Seattle-First National Bank, Wenatchee Valley Branch.

IV.

The original of said check No. 7090 will be filed with the Court as an exhibit upon the trial of this action.

V.

On May 8, 1948, said Trustee made demand on the defendant for the return of said alleged preferential payment but the defendant has failed and refused to return said amount or any portion thereof to the Trustee or the bankrupt estate.

Question for Decision

The question for decision by the court under the facts of this case is whether or not the payment of said check by the Wenatchee Valley Branch of the Seattle-First National Bank on February 3rd, 1947, out of the account of Chemurgy in said bank was a preference in the amount of $1,627.50 within the meaning of a preference as defined in Rem. Rev. Stat. 5831-4 (c).

The foregoing facts and question for the Court are hereby agreed to this .... day of February, 1950.

EGGERMAN, ROSLING & WILLIAMS,

By /s/ DeWITT WILLIAMS,
Attorneys for Plaintiff.

JOSEPH L. HUGHES and W. WALTERS MILLER,

By /s/ JOSEPH L. HUGHES,
Attorneys for Defendant.

EXHIBIT "A"

(Copy)

Centenenial Flouring Mills Co.
Grain Dept.
Home Office, Seattle
Ralston, Wash., 1-3-1947

Northwest Chemurgy Corp.
Wenatchee, Wn.
Dear Sir:

Am mailing Whse. Re #S6035 for 1000 bu. Turkey Red wheat. The market today is $1.70 f.o.b.

Sincerely yours,
RALPH SNYDER, Agt.

P.S. Mail check to Mr. Art Benzel, Ralston, Wn.

EXHIBIT "B"

(Copy)

Northwest Chemurgy Co-Operative
Manufacturers of Starch-Glucose-Dextrose
and By-Products

General Office 533 Doneen Bldg.
Phone 1236
Wenatchee, Washington

January 22, 1947

Mr. Art Benzel
Ralston, Washington.

Dear Mr. Benzel:

We are advised by our bank that the check issued you was returned by them in error, and request that you redeposit this check.

Very truly yours,
NORTHWEST CHEMURGY
COOPERATIVE,
/s/ R. D. WHITMORE l.b.
R. D. WHITMORE,
Grain Department.

RDW:b

[Endorsed]: Filed April 10, 1950.

[Title of District Court and Cause.]

MOTION FOR REHEARING AND RECONSIDERATION

Comes Now the plaintiff and moves the court for an order setting down this case for reargument and reconsideration. This motion is based upon the fact that the plaintiff has never had an opportunity to present to the court by oral argument and brief a full presentation of this case for the reason that defendant filed no brief at the time of the argument and the oral argument on behalf of defendant was likewise very brief and the points subsequently raised on brief were not presented at the oral argument nor did the plaintiff have an opportunity to argue these points to the court. Furthermore, although the court has held that the plaintiff has the burden the defendant filed the final brief and plaintiff, under the circumstances, should have an opportunity to present all of the new issues raised by defendant subsequent to the original argument by oral argument. In view of the fact that practically all of defendant's points were raised subsequent to argument and on briefs which the plaintiff has had no opportunity to argue to the court, it is respectfully submitted that a reargument and reconsideration should in all fairness to the plaintiff be granted.

/s/ EGGERMAN, ROSLING & WILLIAMS,
Attorneys for Plaintiff.

[Endorsed]: Filed August 7, 1950.

[Title of District Court and Cause.]

ORDER

Plaintiff's Motion for Rehearing and Reconsideration in the above-entitled case is hereby denied.

Dated this 7th day of August, 1950.

/s/ SAM M. DRIVER,
United States District Judge.

[Endorsed]: Filed August 7, 1950.

[Title of District Court and Cause.]

RECORD OF OBJECTIONS TO ACTION OF THE COURT AND REQUEST FOR ACTION AT THE TIME OF THE SIGNING AND ENTRY OF FINDINGS OF FACT AND CONCLUSIONS OF LAW

Be It Remembered that at the time of and as a part of the signing and entry of the findings of fact and conclusions of law and judgment herein the plaintiff, pursuant to Rule 46 of the Rules of Civil Procedure made known to the court his objections to the action of the court and made known to the court the action which he desired the court to take, as follows:

Objections to Action of the Court

1. Plaintiff objected to the entry of that portion of the finding of fact III reading: "That the plaintiff has failed to sustain the burden of proving the transaction constitutes an unlawful preference and

was other than a cash transaction" on the grounds (a) that the facts stipulated prove that the payment of the check referred to in finding II on February 3, 1947, was a preference within the meaning of Rem. Rev. Statute 5831-4 and (b) that the transaction referred to in finding II was not a cash transaction and (c) said quotation of purported finding is not contained in the stipulation of facts.

2. Plaintiff objected to the entry of conclusion of law I on the grounds: (a) that the conclusion of law to be drawn from the stipulated facts was that the payment on February 3, 1947, referred to in finding II was a preference within the meaning of Rem. Rev. Statute § 5831-4, (b) that the transaction referred to therein was not a cash transaction as held by the court, (c) that the evidence, facts and findings of fact do not support the statement "* * * there was no intent on the part of either party to create a debtor-creditor relationship," (d) the intent of the parties is immaterial.

3. Plaintiff objected to conclusion of law II that defendant was entitled to have a judgment dismissing the complaint on the ground (a) that the stipulated facts and pertinent law require the entry of judgment as prayed for in the complaint.

4. Plaintiff objected to the entry of judgment dismissing the complaint on the ground that the stipulated facts require, as a conclusion of law, that the payment to defendant of the sum of $1,627.50 on February 3, 1947, was a preference in said amount within the meaning of Rem. Rev. Statute § 5831-4 (c) and was recoverable under

Rem. Rev. Stat. § 5831-6 by the plaintiff herein from the defendant.

5. Plaintiff objected to the failure of the court to answer the question for decision presented by the agreed statement of facts by holding that payment on February 3, 1947, to the defendant was a preference in the amount of said payment within the meaning of a preference as defined in Rem. Rev. Stat. § 5831-4 (c).

At said time plaintiff also made known to the court that he wished the following action to be taken on the ground that such action was required by the stipulated facts and the conclusion of law to be drawn therefrom under the law relating to the recovery of preferential payments as contained in Rem. Rev. Stat. 5831-4 and Rem. Rev. Stat. § 5831-6:

1. That the court enter the following conclusions of law instead of the conclusions entered by the court:

(a) "The payment of said check out of the funds of Chemurgy on deposit with the Wenatchee Valley Branch of The Seattle-First National Bank on February 3, 1947, was a transfer to the defendant of the property of said insolvent Northwest Chemurgy Cooperative, within the meaning of Rem. Rev. Stat. § 5831-4 and a preference recoverable by the plaintiff from the defendant under Rem. Rev. Stat. of the State of Washington § 5831-4 and § 5831-6.

(b) Plaintiff is entitled to judgment against the defendant Arthur Benzel in said sum of

$1,627.50 with interest thereon at the rate of 6% per annum from May 8, 1948, until paid and for plaintiff's costs herein to be taxed.

2. That the court enter judgment for the plaintiff and against the defendant in accordance with the foregoing conclusion of law.

The foregoing record of objections made and request for action of the court made this 5th day of October, 1950, at the time of and as a part of the signing and entry of findings of fact, conclusions of law and judgment herein.

Done by the Court.

/s/ SAM M. DRIVER,
Judge.

The foregoing approved for signing and entry by the court at the time of signing and entry of findings, conclusions and judgment.

/s/ W. WALTERS MILLER,
Of Attorneys for Defendant.

Presented by:

/s/ DeWITT WILLIAMS,
Of Attorneys for Plaintiff.

[Endorsed]: Filed October 5, 1950.

In the District Court of the United States for the Eastern District of Washington, Northern Division

No. 745

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a Corporation, Bankrupt,

Plaintiff,

vs.

ARTHUR BENZEL,

Defendant.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled action came on regularly for trial before the undersigned Judge of the above-entitled Court upon a written statement of agreed facts made and filed by the parties, the plaintiff being represented in Court by his attorneys of record, Eggerman, Rosling and Williams, and DeWitt Williams, and the defendant being represented in Court by his attorneys, Hughes & Jeffers and Joseph L. Hughes, and the Court having considered the facts as agreed and heard the argument of counsel and after due consideration of written briefs filed by both parties; now, therefore, the Court finds the facts in accordance with said agreed statement of facts as follows:

Findings of Fact

I.

At all times herein mentioned Northwest

Chemurgy Cooperative was and is now a Washington corporation, hereinafter referred to as Chemurgy. On May 29, 1947, Chemurgy duly filed a petition for an arrangement under Chapter XI of the Act of Congress relating to Bankruptcy in the United States District Court for the Western District of Washington, Northern Division, Cause No. 37,569. On said date said Court entered an order accepting and approving Chemurgy's petition for an arrangement as properly filed under Chapter XI of said Act. Chemurgy was unable to consummate the proposed arrangement and upon a hearing duly noticed and held pursuant to §376 (2) of the Act of Congress relating to Bankruptcy, said Court on December 13, 1947, duly made and entered its order that Chemurgy is a bankrupt under said Act and that bankruptcy be proceeded with pursuant to the provisions of said Act. Subsequent to said order determining Chemurgy a bankrupt after proceedings duly had therefor, plaintiff on January 6, 1948, was by the order of said Court duly appointed Trustee of the estate of said bankrupt and thereafter on said January 6, 1948, plaintiff duly qualified as Trustee of said estate and since said date at all times has been the duly appointed, qualified and acting Trustee of the said estate of said bankrupt. At all times herein material §5831-4 and §5831-6 of Rem. Rev. Stat. of the State of Washington (Laws of 1941, Chap. 103, §1 and 3) were in full force and effect. For at least four months immediately prior to May 29, 1947, Chemurgy was unable to pay its debts in the ordinary

course of business and was insolvent within the meaning of said statutes of the State of Washington. During all of said four months and at the present time there existed and now exists against said insolvent corporation and said bankrupt estate claims of general unsecured creditors on file with said Court in said bankruptcy proceedings, upon which claims from the inception thereof as debts of the corporation no payment has been made. The claims allowed and allowable in said bankruptcy proceedings are greatly in excess of the estate assets.

II.

On or about January 3, 1947, the defendant Arthur Benzel, by endorsing and delivering to Northwest Chemurgy Cooperative a negotiable warehouse receipt covering 1,000 bushels of wheat, sold and delivered said wheat to said corporation at the agreed net price, after deducting charges for handling, insurance and storage of $72.50, of $1,627.50. On or about January 13, 1947, Northwest Chemurgy Cooperative drew its check for said wheat payable to defendant, being check No. 7090 dated January 13, 1947, drawn on the Wenatchee Valley Branch of the Seattle-First National Bank, Wenatchee, Washington, in said sum of $1,627.50, which check the defendant received on January 14, 1947. Said check has been admitted as an exhibit in this action. On January 18, 1947, defendant first deposited said check for collection in the Ritzville Branch of the Old National Bank. Said bank presented said check for collection to the Wenatchee Valley Branch, Seattle-First National Bank, and said check was

returned because there were no funds on deposit in said Wenatchee Valley Branch, Seattle-First National Bank to pay said check. Said check was redeposited by the defendant with the Ritzville Branch of the Old National Bank for collection and was received from said Ritzville Branch by the Wenatchee Valley Branch of the Seattle-First National Bank on January 27, 1947, but was not then paid because the Chemurgy account with said bank was then overdrawn and remained overdrawn until February 3, 1947, at which time the check was paid out of the account of Northwest Chemurgy Cooperative with said Seattle-First National Bank, Wenatchee Valley Branch.

III.

On May 8, 1948, said Trustee made demand on the defendant for the return of said alleged preferential payment but the defendant has failed and refused to return said amount or any portion thereof to the Trustee or the bankrupt estate.

That the plaintiff has failed to sustain the burden of proving that the transaction constituted an unlawful preference and was other than a cash transaction.

From the foregoing Findings of Fact, the Court draws the following

Conclusions of Law

I.

That payment of said check out of the funds of Chemurgy on deposit with the Wenatchee Valley Branch of the Seattle-First National Bank on Feb-

ruary 7, 1947, was not such a transfer to the defendant of the property of said insolvent Northwest Chemurgy Cooperative as to constitute an unlawful preference within the meaning of Rem. Rev. Stat. of the State of Washington, §5831-4, as the transaction was in substance and effect a cash transaction and there was no intent on the part of either party to create a debtor-creditor relationship.

II.

That defendant is entitled to have entered a judgment against the plaintiff, Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, dismissing plaintiff's complaint with prejudice and awarding defendant judgment for costs herein to be taxed in the sum of $.....

The foregoing Findings of Fact and Conclusions of Law made and entered this 5th day of October, 1950.

/s/ SAM M. DRIVER,
Judge.

Approved as to form subject to "Record of Objections," notice of presentation waived.

/s/ DeWITT WILLIAMS,
Of Attorneys for Plaintiff.

Presented by:

/s/ JOSEPH L. HUGHES,
Of Attorneys for Defendant.

[Endorsed]: Filed October 5, 1950.

In the District Court of the United States for the Eastern District of Washington, Northern Division

No. 745

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a Corporation, Bankrupt,

Plaintiff,

vs.

ARTHUR BENZEL,

Defendant.

JUDGMENT

This matter came on regularly before the undersigned judge of the above-entitled Court for trial on April 10, 1950, upon an agreed statement of facts made and filed by the parties hereto, plaintiff being represented in court by his attorneys, Eggerman, Rosling & Williams, and DeWitt Williams, and the defendant being represented in Court by his attorneys, Hughes & Jeffers, and Joseph L. Hughes, and the Court having made and entered its Findings of Fact and Conclusions of Law requiring entry of judgment for the defendant in accordance with his answer herein; now, therefore, pursuant to said Findings and Conclusions, it is hereby

Ordered, Adjudged and Decreed that the plaintiff's complaint herein be dismissed with prejudice.

It Is Further Ordered, Adjudged and Decreed that the defendant Arthur Benzel be and he is hereby granted judgment against the plaintiff

Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, bankrupt, for his costs herein to be taxed by the Clerk, in the sum of $20.00.

This judgment made and entered in open Court this 5th day of October, 1950.

/s/ SAM M. DRIVER,
Judge.

Approved as to form subject to "Record of Objections," notice of presentation waived.

/s/ DeWITT WILLIAMS,
Of Attorneys for Plaintff.

Presented by:

/s/ JOSEPH L. HUGHES,
Of Attorneys for Defendant.

[Endorsed]: Filed October 5, 1950.

[Title of District Court and Cause.]

NOTICE OF APPEAL

To: Arthur Benzel, defendant and to Joseph L. Hughes, and W. Walters Miller, his attorneys.

You and Each of You are hereby notified that the above named plaintiff, Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, bankrupt, does hereby appeal to the United States Court of Appeals for the Ninth Circuit from the final judgment rendered and entered in the above-entitled cause on October

5, 1950, and from each and every part thereof.

Dated this 16 day of October, 1950.

EGGERMAN, ROSLING & WILLIAMS,

/s/ DeWITT WILLIAMS,

Attorneys for Plaintiff Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative.

Receipt of Copy acknowledged.

[Endorsed]: Filed October 19, 1950.

[Title of District Court and Cause.]

COST BOND ON APPEAL

Know all men by these presents: That we, Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, Bankrupt, as Principal, and United Pacific Insurance Company, as Surety, acknowledge ourselves to be jointly indebted to United States of America, appellee in the above cause, in the sum of Two Hundred Fifty and No/100 ($250.00) Dollars, conditioned that

Whereas, on the 5th day of October, 1950, in the District Court of the United States for the Eastern District of Washington, in a suit pending in that court, wherein Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, Bankrupt, was Plaintiff and Arthur Benzel was Defendant, a judgment was rendered against said Plaintiff and the Plaintiff having filed

in the office of the Clerk of the said District Court a notice of appeal therefrom to the United States Court of Appeals for the Ninth Circuit.

Now the Condition of the Above Obligation Is Such, that if said Plaintiff shall prosecute his appeal to effect and answer all costs, if the appeal is dismissed or the judgment affirmed, or of such costs as the appellate court may award if the judgment is modified, then the above obligation is void, also to remain in full force and effect.

Signed, sealed and dated this 9th day of October, 1950.

/s/ ADOLPH W. ENGSTROM,
Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a Corporation, Bankrupt.

UNITED PACIFIC INSURANCE COMPANY,

[Seal] By /s/ ARMAND MINORCHIO,
Attorney-in-Fact.

Countersigned:

TILESTON GRINSTEAD,
Resident Agent, Seattle, Washington.

[Endorsed]: Filed October 19, 1950.

PLAINTIFF'S EXHIBIT NO. 1

3
41

NORTHWEST CHEMURGY CO-OPERATIVE

MANUFACTURERS OF

STARCH - GLUCOSE - DEXTROSE AND BY-PRODUCTS

GENERAL OFFICE, 126 SO. WENATCHEE AVE.

WENATCHEE, WASHINGTON

No. 7090

January 13 1947

PAY TO THE ORDER OF Art Benzel $1627.50

REGISTERED NO. 7736 $1627 AND 50 CTS DOLLARS

NORTHWEST CHEMURGY CO-OPERATIVE

WENATCHEE VALLEY BRANCH

SEATTLE FIRST NATIONAL BANK

98-12-420 WENATCHEE, WASHINGTON

BY B. L. Stockstill

15

Benzel 1627.50 #745

PLAINTIFF'S EXHIBIT No.

JAN 21 1947

PAY TO THE ORDER OF ANY BANK, BANKER or TRUST CO. Prior Endorsements Guaranteed

JAN 21 1947

RITZVILLE BRANCH

The Old National Bank of Spokane

98-119

Ritzville, Washington

#127621

[Title of District Court and Cause.]

DESIGNATION OF RECORD ON APPEAL

To the Clerk of Said Court:

Herewith we hand you Notice of Appeal and Bond on Appeal in the above entitled cause.

Will you please prepare the Record on Appeal in the manner provided by Rule 75, consisting of all proceedings and evidence in this action, which the appellant understands to consist of the following:

1. Summons and Return of Service.
2. Complaint.
3. Answer.
4. Agreed Statement of Facts.
5. All Exhibits.
6. Motion for Rehearing and Reconsideration.
7. Order Denying Motion for Rehearing and Reconsideration.
8. Findings of Fact and Conclusions of Law.
9. Judgment.
10. Record of Objections to Action of the Court, and Request for Action.
11. Notice of Appeal.
12. Bond on Appeal.
13. Motion to Dismiss.
14. Order Denying Motion to Dismiss.

15. Designation of Record.

EGGERMAN, ROSLING & WILLIAMS,

/s/ DeWITT WILLIAMS,

Attorneys for Plaintiff Appellant Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative.

Receipt of Copy acknowledged.

[Endorsed]: Filed October 27, 1950.

[Title of District Court and Cause.]

CERTIFICATE OF THE CLERK

United States of America,
Eastern District of Washington—ss.

I, A. A. LaFramboise, Clerk of the United States District Court for the Eastern District of Washington, do hereby certify that the documents annexed hereto are the original

1. Complaint.
2. Summons.
3. Motion to Dismiss.
4. Order Denying Motion to Dismiss.
5. Agreed Statement of Facts.
6. Exhibit: Plaintiff's 1, Cancelled Check, Northwest Chemurgy Cooperative to Benzel dated 1/13/47 $1627.50.

7. Motion for Rehearing and Reconsideration.

8. Order Denying Motion for Rehearing and Reconsideration.

9. Record of Objections to Action of the Court and Request for Action at Time of the Signing and Entry of Findings of Fact and Conclusions of Law.

10. Findings of Fact and Conclusions of Law.

11. Judgment for Defendant.

12. Notice of Appeal.

13. Cost Bond on Appeal.

14. Designation of Record on Appeal.

on file in the above entitled cause, and that the same constitutes the record for hearing of the Appeal from Judgment of the United States District Court for the Eastern District of Washington in the United States Court of Appeals for the Ninth Circuit as called for by the Appellant in his designation of record on Appeal.

(Note—Item No. 3 of Plaintiff's Designation, "Answer" is not included for the reason that no answer was filed—the case being tried on an Agreed Statement of Facts.)

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court at

Spokane, in said District, this 8th day of November, A.D., 1950.

A. A. LaFRAMBOISE,
Clerk.

[Seal] By /s/ EVA N. HARDIN,
Deputy.

[Endorsed]: No. 12734. United States Court of Appeals for the Ninth Circuit. Adolph W. Engstrom, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a Corporation, Bankrupt, Appellant, vs. Arthur Benzel, Appellee. Transcript of Record. Appeal from the United States District Court for the Eastern District of Washington, Northern Division.

Filed: November 10, 1950.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals for the Ninth Circuit

No. 12734

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a Corporation, Bankrupt,

Appellant.

vs.

ARTHUR BENZEL,

Appellee.

APPELLANT'S STATEMENT OF POINTS AND DESIGNATION OF RECORD

To: Arthur Benzel and Mr. W. Walters Miller, his attorney:

You and Each of You are hereby notified that appellant's statement of points on this appeal is as follows:

I.

In determining whether a payment of money by an insolvent corporation is a preference within the meaning of Rem. Rev. Stat. of the State of Washington, §5831-4, the intent of the parties is immaterial. The determination is made on the basis of the effect of the payment in diminishing the funds of the corporation in payment of an obligation existing prior to the date of payment.

II.

The obligation here involved arose when wheat was sold and delivered to Chemurgy by appellee on January 3, 1947. Title to the wheat passed to Chemurgy by the delivery on said date of a negotiable warehouse receipt for said wheat. The preferential payment under Rem. Rev. Stat. §5831-4 occurred on February 3, 1947, when the wheat was paid for out of the account of Chemurgy by its bank.

III.

The above described transaction was not a "cash transaction" since the seller (appellee) did not receive payment for said wheat when he sold and delivered it.

IV.

The payment out of the bank account of Chemurgy on February 3, 1947, to appellee was a preference recoverable by appellant as Trustee in Bankruptcy under Rem. Rev. Stat. §5831-4 and §5831-6.

Designation of Record

Appellant hereby designates as material to the consideration of this appeal all of the record certified to the United States Court of Appeals under date of November 8, 1950, by the Clerk of the District Court from which this appeal was taken.

Dated this 17th day of November, 1950.

EGGERMAN, ROSLING & WILLIAMS,

/s/ DeWITT WILLIAMS,
Attorneys for Appellant.

Affidavit of Service by Mail attached.

[Endorsed]: Filed November 18, 1950.

No. 12734

United States Court of Appeals
For the Ninth Circuit

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, Bankrupt, *Appellant,*

vs.

ARTHUR BENZEL *Appellee.*

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF OF APPELLANT

EGGERMAN, ROSLING & WILLIAMS,
DEWITT WILLIAMS,
Attorneys for Appellant.

918 Joseph Vance Building
Seattle 1, Washington.

THE ARGUS PRESS, SEATTLE

No. 12734

United States Court of Appeals
For the Ninth Circuit

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, Bankrupt, *Appellant,*

vs.

ARTHUR BENZEL *Appellee.*

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF OF APPELLANT

EGGERMAN, ROSLING & WILLIAMS,
DEWITT WILLIAMS,
Attorneys for Appellant.

918 Joseph Vance Building
Seattle 1, Washington.

THE ARGUS PRESS, SEATTLE

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has jurisdiction of this appeal from said final decision of the District Court by virtue of Title 28, U.S. Code, §1291, (28 U.S.C.A., §1291).

STATUTES INVOLVED

Appellant brought this action pursuant to Rem. Rev. Stat. of the State of Washington, §5831-4 and §5831-6 (Laws of 1941, Chap. 103) reading as follows:

> Section 5831-4.—Preferences by insolvent corporations.—Definitions. Words and terms used in this act shall be defined as follows: (a) "Receiver" means any receiver, trustee, common law assignee, or other liquidating officer of an insolvent corporation. (b) "Date of application" means the date of filing with the Clerk of the Court of the petition or other application for the appointment of a receiver, pursuant to which application such appointment is made; or in case the appointment of a receiver is lawfully made without court proceedings, then it means the date on which the receiver is designated, elected or otherwise authorized to act as such. (c) "Preference" means a judgment procured or suffered against itself by an insolvent corporation or a transfer of any of the property of such corporation, the effect of the enforcement of which judgment or transfer at the time it was procured, suffered, or made, would be to enable any one of the creditors of such corporation to obtain a greater percentage of his debt than any other creditor of the same class (L. '41, ch. 103, §1).
>
> Section 5831-6—Preference voidable when—Trust fund doctrine superseded. Any preference made or suffered within four (4) months before the date of application for the appointment of a receiver may be avoided and the property or its value re-

> covered by such receiver. No preferences made or suffered prior to such four (4) months' period may be recovered, and all provisions of law or of the trust fund doctrine permitting recovery of any preference made beyond such four (4) months' period are hereby specifically superseded (L. '41, ch. 103, §3).

As stated in *Meier v. Commercial Tire Co.,* 179 Wash. 449 at 451, 38 P.(2d) 383 at 384, the rule now found in these statutes was previously a court made rule. It was enacted into statute first in 1931 and later in 1941 in the form above quoted. The court made rule had been applied in many Washington cases since *Thompson v. Huron Lumber Co.,* 4 Wash. 600, 30 Pac. 741, that payments made by insolvent corporations must be returned upon demand by a liquidating officer.

This rule was frequently invoked by trustees in bankruptcy to recover preferential payments and illustrative cases are *Williams, as Trustee, v. Davidson,* 104 Wash. 315, 176 Pac. 334, and *Woods as Trustee, v. Metropolitan National Bank,* 126 Wash. 346, 218 Pac. 266. In the latter case the court stated:

> "The principle on which the receiver based his action would seem to be well founded in law. Ever since the case of *Thompson v. Huron Lumber Co.,* 4 Wash. 600, 30 Pac. 741, 31 Pac. 25, this court has adhered to the doctrine that an insolvent corporation may not prefer its creditors; that, although an individual creditor may do so, even to the exhaustion of his property, the right does not exist in a corporation; that its property on insolvency becomes a trust fund for the benefit of all of its creditors to be equally and ratably distributed

among them, *Conover v. Hull,* 10 Wash. 673, 39 Pac. 166, 45 Am. St. 810; *Benner v. Scandinavian American Bank,* 73 Wash. 488, 131 Pac. 1149, Ann. Cas. 1914-D 702; *Jones v. Hoquiam Lumber & Shingle Co.,* 98 Wash. 172, 167 Pac. 117; *Simpson v. Western Hardware & Metal Co.,* 97 Wash. 626, 167 Pac. 113; *Williams v. Davidson,* 104 Wash. 315, 176 Pac. 334.

"The foregoing citations announce the further rule, also, that, in an action or suit on the part of the receiver to recover as for an unlawful preference, it is not necessary that he show that the creditor, at the time of receiving the preference, had knowledge or reasonable cause to believe that the corporation was insolvent. See particularly, *Jones v. Hoquiam Lumber & Shingle Co., supra; Williams v. Davidson, supra.*

"Nor were the rights of the parties changed in respect to the right to recover the payments as an unlawful preference by the transfer of the proceedings into the bankruptcy court. By §70e of the bankruptcy act, it is provided that the Trustee in bankruptcy may avoid any transfer by the bankrupt of his property which any creditor of the bankrupt might have avoided, and may recover the property so transferred from the person to whom it was transferred. That this section gives the trustee in bankruptcy a right of action to recover property transferred in violation of state law, and is not subject to the four months' limitation of other sections (60b, 67e) of the Bankruptcy Act, was held by the Supreme Court of the United States in *Stellwagen v. Clum,* 245 U.S. 605."

OPINION BELOW

This action was one of a group brought by the Trustee in Bankruptcy of Northwest Chemurgy Cooperative against certain creditors upon identical forms of complaint to recover alleged preferential payments under the statutes of the State of Washington above referred to.

Many of these cases, including this case, are listed following *Engstrom v. DeVos,* 81 F. Supp. 854. In those cases motions to dismiss were addressed to the complaint and overruled by said opinion. An appeal was taken in one of said cases testing the ruling of the District Court in holding that the complaints stated a cause of action. Upon said appeal the District Court was affirmed by United States Court of Appeals for the Ninth Circuit (*Schneidmiller v. Engstrom,* 177 F.(2d) 196). Pursuant to stipulation contained in the appeal record in the *Schneidmiller* case judgment for the Trustee was therefor entered against all of the defendants so stipulating, the only exceptions being this case and the case against R. M. Wiley which is also now on appeal to the Court of Appeals from a judgment of dismissal. (No. 12733).

This case and the *Wiley* case were submitted on written agreed statements of facts.

The District Court concluded from the findings that the action should be dismissed and entered judgment of dismissal.

The decision of the District Court was unreported.

STATEMENT OF THE CASE

After the allegations of the complaint were held to state a cause of action in *Schneidmiller v. Engstrom,* 177 F.(2d) 196, the parties to this action entered into an Agreed Statement of Facts for submission to the court (Tr. 10-16). Paragraph I of the agreed statement in substance and effect simply restated as agreed facts Paragraphs 1 to 7 inclusive of the complaint so that it is agreed that Northwest Chemurgy Cooperative is a bankrupt, that appellant is the duly authorized and acting trustee, that at all times material the preference statutes of the State of Washington (§§ 5831-4 and 5831-6 of Rem. Rev. Stat. of the State of Washington) were in full force and effect, that Chemurgy was insolvent within the meaning of said statutes for at least four months prior to May 29, 1947 (which period includes the date of February 3, 1947 on which date the check here involved was paid out of the bank account of Chemurgy), that during all of said four months and at all times subsequent thereto there existed and now exists against said insolvent corporation and said bankrupt estate claims of general unsecured creditors upon which no payments have been made and the claims allowed and allowable are greatly in excess of the estate assets (Tr. 10-12).

The effect of said agreement on the facts was to establish beyond question that the payment here involved was a preferential payment recoverable by appellant under said Washington statutes subject only to the final point as to whether the payment to appellee here involved was a transfer of property to a creditor.

On the facts of this payment the District Court found by Finding II as follows:

II.

"On or about January 3, 1947, the defendant Arthur Benzel, by endorsing and delivering to Northwest Chemurgy Cooperative a negotiable warehouse receipt covering 1,000 bushels of wheat, sold and delivered said wheat to said corporation at the agreed net price, after deducting charges for handling, insurance and storage of $72.50, of $1,627.50. On or about January 13, 1947, Northwest Chemurgy Cooperative drew its check for said wheat payable to defendant, being check No. 7090 dated January 13, 1947, drawn on the Wenatchee Valley Branch of the Seattle-First National Bank, Wenatchee, Washington, in said sum of $1,627.50, which check the defendant received on January 14, 1974. Said check has been admitted as an exhibit in this action. On January 18, 1947, defendant first deposited said check for collection in the Ritzville Branch of the Old National Bank. Said bank presented said check for collection to the Wenatchee Valley Branch, Seattle-First National Bank, and said check was returned because there were no funds on deposit in said Wenatchee Valley Branch, Seattle-First National Bank to pay said check. Said check was redeposited by the defendant with the Ritzville Branch of the Old National Bank for collection and was received from said Ritzville Branch by the Wenatchee Valley Branch of the Seattle-First National Bank on January 27, 1947, but was not then paid because the Chemurgy account with said bank was then overdrawn and remained overdrawn until February 3, 1974, at which time the check was paid out of the account

of Northwest Chemurgy Cooperative with said Seattle-First National Bank, Wenatchee Valley Branch."

The agreed statement also presented a single "Question for Decision" by the trial court, reading as follows:

> "The question for decision by the court under the facts of this case is whether or not the payment of said check by the Wenatchee Valley Branch of The Seattle-First National Bank on February 3rd, 1947, out of the account of Chemurgy in said bank was a preference in the amount of $1627.50 within the meaning of a preference as defined in Rem. Rev. Stat. §5831-4(c)" (Tr. 13).

The court's answer to this question is found in its Conclusion of Law I (Tr. 26-27) reading as follows:

> "That payment of said check out of the funds of Chemurgy on deposit with the Wenatchee Valley Branch of The Seattle-First National Bank on February 3, 1947, was not such a transfer to the defendant of the property of said insolvent Northwest Chemurgy Cooperative as to constitute an unlawful preference within the meaning of Rem. Rev. Stat. of the State of Washington, §5831-4, as the transaction was in substance and effect a cash transaction and there was no intent on the part of either party to create a debtor-creditor relationship."

SPECIFICATION OF ERRORS

1. The court erred in entering that portion of Finding of Fact III reading:

> "That the plaintiff has failed to sustain the burden of proving the transaction constitutes an unlawful preference and was other than a cash transaction" (Tr. 26).

for the reasons:

> (a) That the facts stipulated prove that the payment of the check referred to in Finding II on February 3, 1974, was a preference within the meaning of Rem. Rev. Stat. of the State of Washington, §5831-4, and
>
> (b) That the transaction referred to in said Finding II was not a cash transaction and,
>
> (c) Said finding of fact is not contained in the stipulation of facts.

2. The court erred in drawing Conclusion of Law I (Tr. 26-27) to the effect that payment of the check here involved out of the funds of Chemurgy on deposit with its bank on February 3rd, 1947 was not such a transfer to appellee of the property of said insolvent Northwest Chemurgy Cooperative as to constitute an unlawful preference within the meaning of Rem. Rev. Stat. of the State of Washington, § 5831-4 as the transaction was in substance and effect a cash transaction and there was no intent on the part of either party to create a debtor-creditor relationship, for the reasons:

> (a) The Conclusion of Law to be drawn from the stipulated facts was that the payment on February 3rd, 1947, referred to in Finding II was a preference within the meaning of Rem. Rev. Stat. §5831-4.

(b) The transaction referred to therein was not a cash transaction as held by the court.

(c) The evidence, facts and Findings of Fact do not support the statement "* * * there was no intent on the part of either party to create a debtor-creditor relationship."

(d) The intent of the parties is immaterial.

3. The court erred in entering Conclusion of Law II that defendant was entitled to have judgment dismissing the complaint for the reason:

(a) The stipulated facts and pertinent law require the entry of judgment as prayed for in the complaint.

4. The Court erred in entering judgment dismissing the complaint for the reasons:

(a) The stipulated facts require as a conclusion of law that the payment to defendant of the sum of $1627.50 on February 3, 1947, was a preference in said amount within the meaning of Rem. Rev. Stat. §5831-4(c) and was recoverable under Rem. Rev. Stat. §5831-6 by the appellant herein from the appellee.

5. The court erred in not answering the question for decision specifically presented by the agreed statement of facts by holding that the payment of said check out of the bank account of Chemurgy on February 3rd, 1947 was a preference in the amount of said check within the meaning of a "preference" as defined in Rem. Rev. Stat. §5831-4(c).

6. The court erred in not entering as a conclusion of law the conclusion that the payment of said check out of the funds of Chemurgy on February 3rd, 1947

was a transfer to the appellee of the property of said insolvent Northwest Chemurgy Cooperative within the meaning of Rem. Rev. Stat. §5831-4 and a preference recoverable by the plaintiff from the defendant under Rem. Rev. Stat. of the State of Washington §5831-4 and 5831-6.

7. The court erred in not entering judgment as prayed for in the complaint for the reasons stated in the foregoing paragraphs 1 to 6.

ARGUMENT

The appellant's Statement of Points on Appeal are set forth on pages 37 and 38 of the transcript, and may be summarized as follows:

I.

In determining whether a payment of money by an insolvent corporation is a preference within the meaning of the Washington statutes, the intent of the parties is immaterial — the determination is made on the basis of the effect of the payment in diminishing the funds of the corporation in payment of a pre-existing obligation.

II.

The obligation here involved arose on January 3, 1947, the date on which appellee sold and delivered wheat to Chemurgy. The preferential transfer occurred a month later on February 3, 1947 when the wheat was paid for out of the account of Chemurgy by its bank.

III.

Said transaction was not a "cash transaction" since

the seller (appellee) did not receive payment for said wheat when he sold and delivered it.

IV.

The payment out of the bank account of Chemurgy on February 3, 1947 to appellee for said wheat was a preference recoverable by appellant as Trustee in Bankruptcy under Rem. Rev. Stat. of the State of Washington § 5831-4 and § 5831-6.

All of the record on appeal was designated as material to the consideration of this appeal.

Since each of the points on appeal involve all, or at least portions of all, of the Specifications of Error, the case will be argued by appellant under the first three of the foregoing "Statement of Points" and each of said points will be deemed in support of each of the specifications of error. The fourth point logically follows from the first three points.

I.

In determining whether a payment of money by an insolvent corporation is a preference within the meaning of the Washington statutes, the intent of the parties is immaterial—the determination is made on the basis of the effect of the payment in diminishing the funds of the corporation in payment of a pre-existing obligation.

The trial court erroneously concluded (Conclusion of Law I—Tr. 26-27) that there was no intent on the part of either party to create a debtor-creditor relationship. The agreed statement of facts does not support this conclusion.

As opposed to the court's conclusion which has no basis in fact is the legal relationship of debtor and creditor created by the sale and delivery of the wheat.

Preferences made within four months before the date of application for the appointment of a receiver (trustee) may be avoided and the property or its value recovered by such receiver (trustee).

> "Any preference made or suffered within four months before the date of application for the appointment of a receiver may be avoided and the property or its value recovered by such receiver * * *" Rem. Rev. Stat. §5831-6.

It has been conclusively established that February 3, 1947, the date of the payment out of the bank account of Chemurgy to appellee was within the four-months period referred to in the above-quoted Rem. Rev. Stat. § 5831-6. *Engstrom v. DeVos,* 81 F.Supp. 854, affirmed *Schneidmiller v. Engstrom,* 177 F.(2d) 196.

The chronology of events clearly establishes a preferential payment under the Washington statute:

> January 3, 1947—Wheat sold and delivered by appellee to Chemurgy but not paid for (Finding II, Tr. 25);
>
> January 29, 1947 — commencement of the four-months period within which payments constitute preferential payments recoverable by the Trustee in Bankruptcy (this date as to this bankruptcy was authoritatively established by *Engstrom v. DeVos* and *Schneidmiller v. Engstrom, supra*);
>
> February 3, 1947 — payment for said wheat by Chemurgy out of its funds on deposit in the We-

natchee Valley Branch of The Seattle-First National Bank (Finding II, Tr. 21).

Upon obtaining title as aforesaid to said wheat, Chemurgy of course became a debtor of the appellee Benzel and Benzel became a creditor of Chemurgy.

> "Whenever one person by contract or by law is liable and bound to pay another an amount of money certain or uncertain, the relation of debtor and creditor exists between them." 18 C.J. 24.

Some other definitions indicating the broad relationship of debtor and creditor are:

> "One who has a right to require of another the fulfillment of a contract or obligation." *In re Putman* (D.C. Cal.) 193 F. 464, 473.

> "One in whose favor an obligation exists, by reason of which he is or may become entitled to the payment of money." *Pierson v. Hickey,* 16 S.D. 46, 91 N.W. 339, 340.

> "One who has the right to require the fulfillment of an obligation." *In re Wilhelm* (D.C. Md.) 25 F. Supp. 440, 443.

> "One who has a right by law to demand and recover of another a sum of money on any account whatever." *Conrad v. Johnson,* 134 Kan. 120, 4 P. (2d) 767, 769.

Since a Washington statute is the basis of this action, the interpretation of such statute by the Washington court is of course controlling. A number of recent Washington cases interpreting the statute clearly demonstrate that the payment here involved was preferential and recoverable by the appellant as trustee.

They hold that the intent of the parties is immaterial and the test is whether or not the estate of the bankrupt is diminished within the four months period by the transfer to the creditor.

Seattle Association of Credit Men as Assignee v. P. D. Luster, 137 Wash. Dec. 181 (1950), 222 P.(2d) 843, was an action brought to recover an alleged preference under the statute here involved. The action involved three checks made payable to the defendant and paid by the insolvent's bank within the four-months period. The transactions giving rise to the payment of the checks in suit developed in the following manner: The insolvent ordered a planer from the defendant to be shipped to a lumber company in Georgia, and sent, with its purchase order, two checks drawn on the insolvent's bank account. One check constituting the initial down payment on the planer was paid prior to the four months and not involved. The second check for the balance of the price of the planer was submitted by a memorandum stating that the check was to be held until the customer had paid for the shipment in full. This second check in the sum of $5,335.00 was paid out of the insolvent's account within the four-months period. The insolvent also ordered another saw submitting two checks, the first of which was deposited immediately upon receipt and was paid by the insolvent's bank within the four-months period and the second check was also paid within the four-months period. The Supreme Court reversed the trial court and ordered judgment for the plaintiff on all three of said checks paid within the four-months period. The

Supreme Court overruled the contention of the defendant that he only intended to deal on a cash basis, stating:

> "It appears to be the contention of respondents here that North End was never an antecedent creditor of Hosmer, since, as they allege, it was the understanding of the parties that North End was to retain title to the machines until Hosmer had paid for them. The agreements between Hosmer and North End, respondents assert, amounted to no more than contracts to sell, and the sales themselves did not take place until the checks, previously delivered by Hosmer to North End were cashed. Thus, no credit was ever extended to Hosmer, and the sales were cash transactions, since title to the machines, in respondents' view, did not pass until the time that they received their money. From this it would follow that Hosmer's estate was in no degree diminished by the cashing of the checks, and it is respondents' position that there was, consequently, no preference and that *Stern v. Lone* has no application to the present situation."

The court in overruling this contention did so in language equally applicable to such a contention by the defendant (appellee) here. The court stated:

> "The essential problem, therefore, is to determine when the sales transactions were consummated. If they remained executory until North End cashed the checks, then there was no preference in either of the transactions, for North End received adequate consideration for them at that time. If, on the other hand, the sales were completed when North End received the orders and released possession of the machines, the transfers

of money resulting from the subsequent cashing of the checks, amounted to payments on an antecedent debt, and must be regarded as preferences.

"In spite of the repeated insistence of respondent P. D. Luster, sole proprietor of North End, that he only intended to deal on a cash basis, it would seem that the latter is the correct view. Where the circumstances of the case indicate that a given transaction amounts to an extension of credit, it will be treated as such, regardless of whether the parties have so considered it. *Seattle Ass'n of Credit Men v. Daniels,* 15 Wn.(2d) 393, 130 P.(2d) 892. And, as Williston says:

" 'Confusion may be caused by use of the words "cash sale" or "terms cash" by business men. In business dealings these words are frequently used when in reality a short period of credit is contemplated. In such a case it is clear that there is no cash sale in the legal sense. Under the circumstances suggested, it is not contemplated that the buyer shall refrain in the meantime from dealing with the goods or even from reselling them, and if such is the contemplation of the parties, it is impossible to say that the property was not to pass until the price was paid.' 2 Williston on Sales (Rev. Ed.) 335, §343.

* * * * *

"It is thus apparent that North End parted with all dominion and control over the machines. Substantially the only evidence tending to show that it retained the title to them consisted of Mr. Luster's statements, made after the fact of Hosmer's insolvency, that it had been his intention to retain the title. Perhaps it was. The trial judge thought so. But whatever Mr. Luster's intention may have

been, it could not alter the legal effect of his actions. If it was indeed his purpose to require that he be paid for the machines prior to passage of title, he waived this requirement by permitting Hosmer to ship the machines to its own subpurchasers, sell them, and take over the proceeds, without insisting on payment in full. *Weyerhaeuser Tbr. Co. v. First Nat. Bank,* 150 Ore. 172, 38 P.(2d) 48, modified 150 Ore. 172, 43 P.(2d) 1078; *Northwest Hardware Co. v. M. & S. Logging Co.,* 132 Wash. 413, 232, Pac. 274.

"The sales having been consummated on December 23rd and December 26th, respectively, North End became a creditor of Hosmer for the obligations in question on those dates. The cashing of checks Nos. 7437, 7349, and 7350 amounted to payments against these obligations, and, since they occurred within four months prior to Hosmer's assignment for the benefit of his creditors, must be held to have been preferential transfers within the meaning of Rem. Supp. 1941, §5831-4(c). Appellant is, therefore, entitled to avoid them."

The Washington case of *Seattle Assoc. of Credit Men v. Daniels,* 15 Wn.(2d) 393, 130 P.(2d) 892, also emphasizes that the intention of the parties as to the extension of credit is immaterial. The court there stated:

"It would seem clear that the payment made by appellant to respondents on April 10th was upon an antecedent debt. Under the express terms of the contract, the account was payable 'upon presentation of receipted bills and pay roll,' which was

when 'audited and found correct to be paid in full.' The receipted bills and statement were presented, audited, and found correct on March 22nd. Payment was not then made. In other words, the account was not paid when due nor at the time the materials were furnished and the services rendered. Consequently, the respondents became general creditors of Eba's Inc. When payment was made on April 10th, it was for an antecedent debt and constituted a preference under Rem. Rev. Stat., §5831-2. *Seattle Ass'n of Credit Men v. Bank of California,* 177 Wash. 130, 30 P.(2d) 972. That the parties did not regard nor intend the transaction as an extension of credit, makes the payment nonetheless a preference. Nor does usage or custom in payment of bills make it any less so. *In re John Morrow & Co.,* 134 Fed. 686. Of a closely analogous situation, the court in that case said, p. 687:

" 'If the parties, by agreement, can treat a sale of goods on 10 days' time as a cash transaction, they may also, by agreement, treat a sale on 30 or 60 days' or longer time as a cash transaction, and practically defeat the operation of sections 57g and 60a of the bankrupt act (30 Stat. 560, 562 (U.S. Comp. St. 1901, pp. 3443, 3445)). Sections 57g and 60a of the bankrupt act do not contemplate a usage of merchants or a conventional arrangement between the parties which would enable any one of the creditors of a bankrupt to obtain a greater percentage of his debt than any other of such creditors of the same class. A sale of goods to be paid for in 10 or 30 days is not, in fact, a cash transaction, and cannot, by agreement of the parties, or a usage of merchants, be regarded as such within the meaning of the bankrupt law'." *Seattle Ass'n. of Credit Men v. Daniels,* 15 Wn.(2d) 393 at pages 397, 398.

II.

The obligation here involved arose on January 3, 1947, the date on which the appellee sold and delivered wheat to Chemurgy. The preferential payment occurred a month later when the wheat was paid for out of the account of Chemurgy by its bank.

It has been demonstrated under Point I above that the obligation of appellee to Chemurgy arose when the wheat was sold and delivered prior to the four-months period to Chemurgy. The check itself was evidence that an indebtedness existed.

> "Under the law, a check is an instrument by which a depositor seeks to withdraw funds from a bank. As between the drawer and the payee, it is an evidence of indebtedness. Usually a check is given for money borrowed or a debt contracted, and, in commercial transactions, as well as in law, it is equivalent to the drawer's promise to pay, and an action may be brought thereon as upon a promissory note. 1 Morse, Banks & Banking, §388. The check then in controversy in this case was an obligation on the part of H. E. Newman & Sons to pay a debt to the plaintiff, and, when payment was declined by the drawee, the plaintiff had a right of action to recover the debt of which such check was a mere evidence." *Camas Prairie State Bank v. Newman,* 15 Idaho 719, 99 Pac. 833 at page 834.

The check did not create the obligation. The obligation was created by the sale and delivery to Chemurgy. The check was the admission by Chemurgy of the existence of an obligation.

> "The giving of a check is not the creation of an obligation, but is merely the admission by the

drawer of the existence of an obligation to pay a certain sum of money." *Peninsula National Bank v. Peterson Construction Co.,* 91 Wash. 621, 158 Pac. 246 at page 247.

The payment of this antecedent obligation evidenced by said check occurred when the check was paid within the four-months period.

The cashing of a check within the four-months period effects a preferential transfer which may be avoided notwithstanding that the check was delivered prior to the beginning of the four-months period, *Stern v. Lone,* 32 Wn. (2d) 785, 203 P.(2d) 1074 (quoted *infra*).

III.

Said transaction was not a "cash transaction" since the seller (appellee) did not receive payment for said wheat when he sold and delivered it.

This was not a cash sale. In a cash sale the seller "declines to transfer either title or right to possession until he is paid." 2 Williston on Sales, Revised Edition, 324, § 341. By the agreed facts title and possession passed from appellee on January 3, 1947 and he was not paid until a month later. The court found that the wheat was sold and delivered on January 3rd, 1947. It is very clear that appellee made no attempt to reserve title until he was paid. The letter transmitting the warehouse receipt (Exhibit A, Tr. 16-17) did so with no reservations, and by the postscript also recognized that a check would not be mailed until after the warehouse receipt was received by Chemurgy. The postscript reads: "P.S. Mail check to Mr. Art Benzel, Ralston, Wn." (Tr. 17). The account statement set forth in the

statement of facts (Tr. 14) shows that certain computations and deductions were required before a check could be prepared.

The delivery of the warehouse receipt vested title to the wheat in Chemurgy. Rem. Rev. Stat. of the State of Washington §3627 provides with respect to the vesting of title by the delivery of a negotiable warehouse receipt as follows:

> "*Rights of person to whom a receipt has been negotiated.* A person to whom a negotiable receipt has been duly negotiated acquires thereby, (a) Such title to the goods as the person negotiating the receipt to him had or had ability to convey to a purchaser in good faith for value, and also such title to goods as the depositor or person to whose order the goods were to be delivered by the terms of the receipt had or had ability to convey to a purchaser in good faith for value, and (b) The direct obligation of the warehouseman to hold possession of the goods for him according to the terms of the receipt as fully as if the warehouseman had contracted directly with him. (L. '13, p. 282, §41).

The Uniform Sales Act which also has been adopted by the State of Washington also provides (Rem. Rev. Stat. §5836-33) that the negotiation of a negotiable document of title immediately transfers the title to the goods previously owned by the endorser. Said section provides:

> "*Rights of Person to whom document has been negotiated.* A person to whom a negotiable document of title has been duly negotiated acquires thereby: (a) Such title to the goods as the person negotiating the document to him had or had ability

> to convey to a purchaser in good faith for value and also such title to the goods as the person to whose order the goods were to be delivered by the terms of the document had or had ability to convey to a purchaser in good faith for value: and (b) The direct obligation of the bailee issuing the document to hold possession of the goods for him according to the terms of the document as fully as if such bailee had contracted directly with him."

Chemurgy was free to deal with the wheat as its own from the moment it received the warehouse receipt. Therefore the following from *Seattle Association of Credit Men v. Luster,* 137 Wash. Dec. 181, 22 P.(2d), 843, quoting Williston is relevant and applicable:

> "Under the circumstances suggested it is not contemplated that the buyer shall refrain in the meantime from dealing with the goods or even from reselling them, and if such is the contemplation of the parties, it is impossible to say that the property was not to pass until the price was paid."

The mailing of the check after the delivery of the wheat was of course not payment for the wheat and it in no wise affected the debt arising by reason of the sale of the wheat to Chemurgy; *Stern v. Lone,* 32 Wn.(2d) 785, 203 P.(2d) 1074, *infra; National Market Co. v. Maryland Casualty Co.*, 100 Wash. 370, 170 Pac. 1009, 174 Pac. 479 (quoted in *Stern v. Lone*); *Anderson v. National Bank of Tacoma,* 146 Wash. 520, 264 Pac. 8. The District Court therefore erred in holding that the "transaction was in substance and effect a cash transaction" (Tr. 22).

Even if the Statement of Agreed Facts had contained

a statement that the parties intended a cash transaction, such intention under the actual circumstances, would have been immaterial. The following holding in *Seattle Association of Credit Men v. Daniels,* 15 Wn.(2d) 393, 130 P.(2d) 892, provides a complete answer to the District Court's reliance upon its unjustified conclusion that there "was no intent on the part of either party to create a debtor-creditor relationship." (Tr. 22).

> "That the parties did not regard nor intend the transaction as an extension of credit, makes the payment nonetheless a preference." *Seattle Association of Credit Men v. Daniels,* 15 Wn.(2d) 393, 130 P.(2d) 892.

As will be noted from the above quotation from *Seattle Association of Credit Men v. Luster,* the Supreme Court of Washington unqualifiedly held in *Stern v. Lone,* 32 Wn.(2d) 785 (1949), 203 P.(2d) 1074, that checks cashed within the four-months period preceding application for the appointment of receiver for the maker, effected a preferential transfer which may be avoided by the receiver notwithstanding that the checks were delivered prior to the beginning of the period. In the *Stern* case the defendant, a farmer, had delivered a considerable amount of corn to the Ingalls Packing Corporation which was delivered by Lone prior to the date four months before application was made for a receiver for Ingalls Packing Corporation. The check was honored by Ingalls' bank within the four-months period. The defendant contended that the preference was made when the check was delivered to him and this date being prior to the four-months period the

receiver could not recover the payment. The receiver contended that the preference was made when the insolvent's bank cashed the check within the four-months period. In holding for the receiver and reversing the trial court the Supreme Court stated:

> "The appellant opens his argument by citing Rem. Rev. Stat. §3579 (P.P.C. §751-9), which reads as follows:
>
> " 'A check of itself does not operate as an assignment of any part of the funds to the credit of the drawer with the bank, and the bank is not liable to the holder unless and until it accepts or certifies the check.'
>
> "This statutory provision has been applied in numerous Washington decisions. *Lincoln County v. Gibson,* 143 Wash. 372, 255 Pac. 119; *Whorf v. Seattle Nat. Bank,* 173 Wash. 629, 634-635, 24 P.(2d) 120. It was held in *National Market Co. v. Maryland Cas. Co.,* 100 Wash. 370, 380, 170 Pac. 1009, 174 Pac. 479, an En Banc decision correcting a previous Departmental opinion in the same cause:
>
> " 'The fundamental error in our former opinion was the holding that the indorsement and delivery of the check was the assignment of the debt, instead of its being simply and only what the negotiable instruments law provides it shall be. The ordinary bank check is not, either in law or in equity, an assignment of the fund upon which it is drawn (Rem. Code, § 3579), but is purely and simply an order for the payment of money, which in nowise affects the debt for which it is given until the order is paid; and being dishonored, leaves the drawer still indebted to the payee, the

same in all respects as though the check had never been drawn and delivered. Moreover, such a check is revocable by the drawer at any time before it is paid. *Peoples' Sav. Bank & Trust Co. v. Lacey,* 146 Ala. 688, 40 South 346; *Pease & Dwyer v. State Nat. Bank,* 114 Tenn. 693, 88 S.W. 172; *Kaesemeyer v. Smith,* 22 Idaho 1, 123 Pac. 943; Ann. Cas. 1914C 665, 43 L.R.A.(N.S.) 100.'

"Later, in the case of *Anderson v. National Bank of Tacoma,* 146 Wash. 520, 525, 264 Pac. 8, it was said by this court:

" 'We have accordingly many times held that the ordinary bank check is not, either in law or equity, an assignment of the funds upon which it is drawn (§ 3579 supra), but is purely and simply an order for the payment of money which in nowise affects the debt for which it is given until the order is paid. *National Market Co. v. Maryland Casualty Co.,* 100 Wash. 370, 170 Pac. 1009, 174 Pac. 479, 1 A.L.R. 450.' * * *

"We are, of course, not here concerned with what constitutes payment with respect to the statute of frauds, nor are we primarily concerned with the date when Lone received 'payment' for his corn. Our statutory definition of 'preference,' quoted earlier in this opinion, contemplates two kinds of preferences: (1) suffering a judgment, and (2) a *transfer* of any of the property of the corporation. No judgment is involved in this case. We are primarily concerned here with whether or not the property of the corporation was diminished by a transfer of corporate property to Lone, and if so, was the transfer made more than four months before May 9, 1947, or within that four months?

In deciding the question before us, the word 'transfer' is the key word, not 'payment.'

"The provisions of the Federal bankruptcy act are so similar to those of our insolvent corporations act (Laws of 1941, chapter 103) that there are many decisions of the Federal courts which are in point. We will, however, in an effort to attain reasonable brevity, refer to them only incidentally. In the opinion in *Continental Trust Co. v. Chicago Title & Trust Co.*, 229 U.S. 435, 443, 57 L.ed. 1268, 33 S.Ct. 829, the supreme court of the United States said:

" 'To constitute a preferential transfer within the meaning of the Bankruptcy Act there must be a parting with the bankrupt's property for the benefit of the creditor and a consequent diminution of the bankrupt's estate.'

"In 4A Remington on Bankruptcy (5th ed.) 265, § 1713, discussing 'Voidable Preferences,' the author says:

" 'Unless property is actually transferred to a creditor, there can be no diminution of the estate.'

"That is also true under our statute on insolvent corporations.

"It seems clear to us that no transfer of property was made by the delivery of the check to Lone on some day during the last week of 1946. It follows that the corporation's property was in no way diminished when the check was delivered to Lone, since he then received no property of the corporation, other than a piece of paper, by means of which he could in the future secure some of the corporation's money, if the corporation did not in the meantime stop payment of the check and there

was still sufficient of the corporation's money remaining on deposit in the bank to honor the check at the time it was presented. As it happened, there was, and it did honor the check on January 25, 1946, and Lone at once received the money through the Kent bank. It was when the check was cashed that corporate assets were transferred and a preference made. That was late in January, 1947, and within four months before May 9, 1947, the date of the application for the appointment of a receiver, and therefore a preference, which could be avoided and a recovery had from Lone by the receiver, under the Laws of 1941, Chapter 103, § 3, p. 272, Rem. Supp. 1941 § 5831-6. * * *

"For the foregoing reasons, we are of the opinion that the corporation's estate was diminished when the check was cashed, not when it was delivered; that is to say, the diminution occurred late in January, 1947, and well within the four months prior to the appellant's application for a receiver on May 9, 1947. It follows that the judgment appealed from must be reversed, and that will be the ruling of this court.

"It is further ordered that the existing judgment be set aside and a new judgment entered in accordance with the prayer of the complaint and consistent with this opinion."

Unless the creditor holds a security all inquiry regarding the status of a preference is limited to what took place within the four-months period.

In the case of *Seattle Assoc. of Credit Men v. Hudson Machinery Company,* 135 Wash. Dec. 643 (1950), 214 P.(2d) 681, the defendant had sold to the insolvent a motor prior to the four-months period and re-

ceived payment one day within the four-months period. The defendant there contended that it had not received a preference because

> "* * * of the nature of this transaction, whereby the payment made by the insolvent was balanced by funds or property supplied by the creditor, respondent is in a different class than other unsecured creditors."

The Supreme Court in overruling this contention and reversing the trial court and ordering judgment for the receiver stated:

> "The answer is no. Respondent does not claim any priority by reason of the various statutes creating liens or otherwise establishing priority of debts. (See, for example, Rem. Rev. Stat. §§1129, 1131-4, 1132, 1141, 1149, 1154, 1156, 7682, 11260.) Respondent was not entitled to a greater percentage because of any security it held, for it held none. It is this fact which distinguishes the instant case from the cases cited by respondent (citing cases).
>
> "Respondent was not entitled to a greater percentage because of credit extended to the insolvent in connection with the sale of the motor, whether or not the motor was resold at a profit, for the state preference act expressly limits any setoff to credit or credits given wholly within the four months' period. * * *
>
> "Since respondent, as a *claimant* against the estate of the insolvent, would not have been entitled to a greater percentage of its claim than any other unsecured creditor, then, under the test referred to above, it was in the same class with them. The payment in question was accordingly a preference. Since the preference was extended

within the four months' period, it was voidable and recoverable in this action. Rem. Supp. 1941, § 5831-6.

"Respondent, in its argument, has emphasized the fact that the motor was resold at a profit. To the extent that this is intended to show that respondent is in a different class than other unsecured creditors, it is answered by what has been said above. On the other hand, if it is contended that this circumstance shows that the payment in question did not diminish the insolvent's estate, and so was not a transfer of property within the meaning of the act, such contention is negatived by the express term of Rem. Supp. 1941, § 5831-7, quoted above.

"Whatever may have been the law prior to the enactment of the state preference act in 1941, the legislature has now provided, with respect to preference payments made in discharge of unsecured credits, a definite cut off date, represented by the beginning of the four months' period. There may be inquiry beyond that date with respect to any claim that a preference represents payment of a credit which has priority or lien protection under statute, or which is secured by agreement of the parties. But absent such a claim, all inquiry regarding the status of a preference is limited to what took place within the four months' period. Thus secured or unsecured credits received by the insolvent from the creditor within four months' period may be set off against the preference, whether or not the insolvent made a profit on the transaction. But credits received by the insolvent from the creditor prior to the four months' period, unless enjoying statutory priority or secured in

some manner, may not be set off or taken into consideration in any other way, whether or not the insolvent made a profit on the transaction.

"For the same reason, that is, that the cut off date provided in Rem. Supp. 1941, §5831-7, is now controlling as to the type of transaction in question, respondent's other contentions to the effect that the sale of the motor and the payment were made 'contemporaneous'; that the payment was made 'in the ordinary course of business'; and that the payment was made in connection with a transaction the 'net result' of which was to increase the value of the estate, are inapposite, assuming that they are meritorious in other respects."

Even if the District Court intended by its conclusion that the transaction was a cash transaction in the "popular sense" because a check was to be mailed after the warehouse receipt was received, such conclusion would not sustain a finding that the ultimate payment of the check was not a statutory "preference." The determining point is that the funds of the insolvent corporation were diminished within the four-months period (by payment out of it bank account) for a debt created prior to the four-months period. This is emphasized in the following quotation from *Stern v. Lone,* 32 Wn.(2d) 783, 203 P.(2d) 1074, the court stating:

"We are, of course, not here concerned with what constitutes payment with respect to the statute of frauds, nor are we primarily concerned with the date when Lone received 'payment' for his corn. Our statutory definition of 'preference' quoted earlier in this opinion, contemplates two

> kinds of preferences: (1) suffering a judgment, and (2) a transfer of any of the property of the corporation. No judgment is involved in this case. We are primarily concerned here with whether or not the property of the corporation was diminished by a transfer of corporate property to Lone, and if so, was the transfer made more than four months before May 9, 1947, or within that four months? In deciding the question before us, the word 'transfer' is the key word, not 'payment'."

The determination of whether a payment is preferential when a transfer is made to an unsecured creditor is dependent solely upon what occurs within the four-months' period. See *Seattle Assoc. of Credit Men v. Hudson,* 135 Wash. Dec. 643, 214 P.(2d) 681, quoted above.

SUMMARY AND CONCLUSION

Appellant contends:

(a) That appellee became a creditor of Chemurgy on January 3, 1947 when he sold and delivered wheat to Chemurgy (said date is prior to the commencement of the four-months' statutory preference period);

(b) On February 3, 1947 (which is within the four-months' statutory preference period), the sum of $1,627.50 was transferred from the assets of Chemurgy to appellee in payment of said debt;

(c) Since this payment diminished the assets of Chemurgy and was in payment of an existing obligation it was a "preference" within the meaning of the Washington preference statute (Rem. Rev. Stat. § 5831-4(c)) and recoverable by the appellant as trustee (Rem. Rev. Stat. § 5831-6).

Appellant submits that the judgment of the District Court should be reversed with instructions to enter judgment for appellant as prayed for in the Complaint.

Respectfully submitted,

EGGERMAN, ROSLING & WILLIAMS

DEWITT WILLIAMS

Attorneys for Appellant

No. 12734

United States Court of Appeals

For the Ninth Circuit

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, Bankrupt,

Appellant,

vs.

ARTHUR BENZEL

Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

Brief of Appellee

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APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON NORTHERN DIVISION

BRIEF OF APPELLEE

JURISDICTION

District Court

This is an action by a trustee in bankruptcy to recover payment of moneys alleged to be a preference and voidable under the laws of the State of Washington, Rem. Rev. Stat. § 5831-4 § 5831-6, (Complaint Tr. 3-6). Jurisdiction is conferred upon the District Court by virtue of Sec. 70 (e) (3) of the Bankruptcy Act (U. S. C. A., § 110 (e) (3).

Circuit Court

The appeal here is from a final decision of the District Court for the Eastern District of Washington, Northern Division, entered October 5, 1950 (Tr.

28-29), dismissing the action of the trustee in bankruptcy and this court is vested with jurisdiction by virtue of Title 28, U. S. Code §1291, (28 U. S. C. A., §1291).

STATUTES INVOLVED

Appellant's action is based upon Rem. Rev. Stat. of the State of Washington, being §5831-4 and §5831-6 (Laws of 1941, Chap. 103) as set forth in appellant's brief. A Preference is claimed. "Preference" is defined by sub-paragraph (c) Rem. Rev. Stat. 5831-4 as follows:

> " 'Preference' means a judgment procured or suffered against itself by an insolvent corporation or a transfer of any of the property of such corporation, the effect of the enforcement of which judgment or transfer at the time it was procured, suffered, or made, would be to enable any one of the creditors of such corporation to obtain a greater percentage of his debt than any other creditor of the same class." (L. '41, ch. 103, §1)

It is apparent from reading the statute that the language of the definition refers to payment of a pre-existing debt and was never intended to apply to a cash sale where delivery of goods and payment therefor are concurrent and mutually dependent acts, or where the check accepted in payment of such goods was dishonored on presentation.

STATEMENT OF THE CASE

The appellant and appellee each presented differ-

ent versions of the transaction in question as contained in the "Agreed Statement of Facts." In view of the conclusions of the Honorable Sam M. Driver, Judge of the United States District Court, it will be properly assumed in presenting appellee's statement of the case that the District Court adopted appellee's version of the transaction in question as follows:

On January 3, 1947, the Defendant Benzel desired to sell and Chemurgy desired to buy 1000 bushels of wheat represented by a negotiable warehouse receipt. Negotiations looking to the sale of the wheat were conducted by Mr. R. D. Whitmore on behalf of Chemurgy and Mr. Ralph Snyder on behalf of Benzel. Snyder, as agent for Benzel, had no authority to sell said wheat *except for cash* and so informed Whitmore (Tr. 13).

> "* *That Whitmore thereupon informed Snyder that the sale would be a cash sale * * and promised that the check of Northwest Chemurgy would be mailed January 3, 1947, in the sum of $1627.50, payable to Benzel, * *" (Tr. 13).

Whitmore further informed Snyder that to effect a cash sale the warehouse receipt in question must be mailed to Chemurgy the same date.

Whitmore selected the channels (via mail) through which delivery of the check and warehouse receipt were to be accomplished. Benzel resided in Ralston, Washington and Chemurgy is located in Wenatchee, Washington (Tr. 12).

That although the delivery of the warehouse receipt and the check in payment therefor were to be simultaneous acts, Chemurgy failed to mail the check on January 3, 1947. (Tr. 13).

Chemurgy's check was dated January 13, 1947, and received by Benzel January 14, 1947.

Benzel never at any time authorized Chemurgy to delay either payment or delivery of the check.

That the check was deposited by Benzel in the Ritzville Branch of the Old National Bank on January 18, 1947, presented for collection to Wenatchee Valley Branch, Seattle-First National Bank and returned "because there were no funds on deposit * * to pay said check." (Tr. 14-15).

Benzel then contacted Whitmore and Whitmore by letter dated January 22, 1947, falsely advised Benzel that the check had been returned by the bank in error and requested Benzel to re-deposit the check (Tr. 15) (Exhibit "B" Tr. 17).

Benzel re-deposited the check and the same was received by Wenatchee Valley Branch Seattle-First National Bank January 27, 1947, but was not paid for lack of funds until February 3, 1947.

Upon oral argument and briefs and based on the "Agreed Statement of Facts" the District Court found "* * that the plaintiff has failed to sustain the burden of proving that the transaction constituted an unlawful preference and was other than a cash

transaction." (Paragraph III Findings of Fact and Conclusions of Law Tr. 26).

The District Court thereupon concluded as follows:

I.

That payment of said check out of the funds of Chemurgy on deposit with the Wenatchee Valley Branch of the Seattle-First National Bank on February 7, 1947, was not such a transfer to the defendant of the property of said involvent Northwest Chemurgy Cooperative as to constitute an unlawful preference within the meaning of Rem. Rev. Stat. of the State of Washington, §5831-4, as the transaction was in substances and effect a cash transaction and there was no intent on the part of either party to create a debtor-creditor relationship.

The District Court thereafter on October 5, 1950, entered its Judgment dismissing appellant's action (Tr. 28-29).

INTRODUCTORY ARGUMENT

1. AS A MATTER OF FACT: The transaction in question was a cash sale as shown by the "Agreed Statement of Facts" (Tr. 10-16), and therefore not a "Preference" as defined by Rem. Rev. Stat. 5831-4 (c).

2. AS A MATTER OF LAW: "Where the buyer of goods pays for the same by a check, which is dis-

honored on presentation, the seller may retake the goods or recover the proceeds thereof from the trustee in bankruptcy of the buyer, Perpall (1919) 168 C. C. A. 104, 256 Fed. 758" (31 A. L. R. 586 note "e creditor of buyer").

ARGUMENT

I.

In the absence of an agreement to the contrary, it is presumed that a sale of personal property is a cash sale.

II.

Where upon a cash sale of wheat a check is accepted as means of payment, such payment is conditional only and between the immediate parties title in the buyer does not become absolute until the check is paid.

III.

Where a seller accepts payment of goods by a check dishonored on presentation, the seller may either recover the proceeds of the sale or retake the property from a trustee in bankruptcy of the buyer for the reason:

(a) Payment by check is required by commercial necessity to be a conditional payment.

(b) Title to the goods does not pass until the check is paid.

(c) General creditors have no legal or moral

right to the property so acquired as no consideration flows to seller until payment of the check.

(d) Relinquishment of seller's right to retake the property creates a present consideration for the subsequent payment of a dishonored check.

I.

In the absence of an agreement to the contrary, it is presumed that a sale of personal property is a cash sale.

The "Agreed Statement of Facts" demonstrates conclusively that a cash sale of wheat was effected by Benzel and Chemurgy. Even in the absence of the "Agreed Statement of Facts" we arrive at the same conclusion. Credit was not extended to Chemurgy, nor did Benzel extend the time in which payment was to be made to him. Delivery of the warehouse receipt representing the wheat to be sold was made through the customary channels of commerce (via mail) and at the request of Chemurgy. It was agreed the sale would be for cash. The delivery of the warehouse receipt and the check in payment therefor were concurrent and mutually dependent conditions. It is commercially impracticable, as suggested by appellant, to treat the delivery of negotiable paper and the acceptance of payment therefor by check as a credit transaction. Such is not the policy of the law nor the custom of the trade. To so hold would place an unnecessary burden on commerce and would prevent the sale of millions of bushels of wheat annually

except on overburdening escrow arrangements. Millions of bushels of wheat are sold for cash by the endorsement and delivery of negotiable warehouse receipts in exchange for checks in payment thorefor. It would be relatively impossible for any warehouseman to keep sufficient funds on hand to pay for the purchase of wheat in cash.

Washington is by statute committed to the rule that delivery of goods and payment therefor are concurrent conditions, each dependent on the other. Rem. Rev. Stat., Laws of the State of Washington, §*5836-42* is quoted as follows:

> "Delivery and payment are concurrent conditions. Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions; that is to say, the seller must be ready and willing to give possession of the goods to the buyer in exchange for the price and the buyer must be ready and willing to pay the price in exchange for possession of goods." *(L. '25, Ex. Ses., p. 372, § 42).*

Consequently, where a check is accepted as payment for personal property, payment is conditional and title to the property, *as between the parties*, does not pass until the check is paid on presentation. If such check is presented and payment is refused for want of funds the seller can elect to retake the property or recover the proceeds thereof. This proposition is fully supported and is the Washington rule as shown by subsequent cited authority.

Since Benzel and Chemurgy did not agree to give,

extend or accept credit the transaction even in the absence of the "Agreed Facts," is presumed to be a cash sale. A precise and well worded definition of the general rule appears in *Gustafson v. Equitable Loan Association*, 186 Minn. 236, 243 N. W. 106 (1932) at page 107 of the Reporter.

> "In the absence of evidence indicating that credit is to be given, a sale is presumed to be for cash. In the instant case, it was expressly stated that the sale was to be for cash."

In the case at bar, it was expressly stated by Whitmore representing Chemurgy that the sale was to be for cash.

> "Whitmore thereupon informed Snyder that the sale would be a cash sale." (Tr. 13).

The writer quotes again from page 107, *Gustafson v. Equitable Loan Association* (supra).

> "Payment and delivery in the sale of personal property are concurrent and mutually dependent acts. If the payment is evaded by the purchaser upon getting possession of the property, the seller may immediately reclaim the property; the title in such case not passing to the purchaser, the delivery being merely conditional, and the purchaser taking simply as trustee for seller until the condition is performed."

Although all facts indicate a cash sale of wheat in the ordinary course of business the transaction would not be different in the absence of the agreed facts. A cash sale is presumed. No presumption of extension of credit arises from the acceptance of a check in payment of goods, or that the check is absolute pay-

ment for the goods. On the contrary, the rule is otherwise. Again quoting from *Gustafson, supra* at page 107:

> "A check is not payment. It is only so when the cash is received on it. There is no presumption that a creditor takes a check in payment, arising from the mere fact that he accepts it from his debtor. The presumption is just the contrary. Where payment is made by check drawn by a debtor on his banker, this is merely a mode of making a cash payment, and not giving or accepting a security. Such payment is only conditional, or a means of obtaining the money. In one sense the holder of the check becomes the agent of the drawer to collect the money on it; and if it is dishonored there is no accord and satisfaction of the debt. * * Where goods are sold for cash on delivery and payment is made by the purchaser by check on his banker, such payment is only conditional, and the delivery of the goods also only conditional; and if the check on due presentation is dishonored, the vendor may retake the goods." (Cited cases omitted). "It follows that the title never passed from plaintiff to Madden."

II.

Where upon a cash sale of wheat a check is accepted as means of payment, such payment is conditional only and between the immediate parties title in the buyer does not become absolute until the check is paid.

The proposition of law above is not only controlling in the case at bar, but is the Washington rule and is adhered to by Federal Courts and courts generally:

In *Quality Shingle Co. v. Old Oregon Lumber & Shingle Co.*, 110 Wash. 60, 187 Pac. 705, the Wash-

ington Supreme Court had before it a case in which the seller delivered a non-negotiable bill of lading for shingles upon receiving a check for the purchase price. The check was subsequently dishonored for lack of funds. Even though the rights of a third party had intervened, the court held at page 63 of the Washington Report:

> "That the sale agreement entered into between respondent and the Shepard-Traill Company was an agreement for a cash sale, that Shepard-Traill Company obtained possession of the bill of lading by giving its check for the agreed purchase price to respondent and by representing to the respondent that the check would be paid upon presentation, that respondent took the check believing in good faith that it was in fact being paid for the shingles in cash, and that the check was promptly in due course presented for payment which payment was refused, we think is quite clear.
>
> "It seems to us to follow, in the light of elementary rules of law, that, as between respondent and Shepard-Traill Company, the title to the shingles did not pass from respondent to Shepard-Traill Company upon it receiving the bill of lading for the shingles and giving its check to respondent therefor."

The same result was reached in *Standard Investment Co. v. Town of Snow Hill, N. C.*, 78 Fed. (2d) 33, where a negotiable bond was sold and the check in payment therefor dishonored on presentation as shown by the language of the Fourth Circuit Court appearing at page 35 as follows:

> "P. 35. There can be no question, we think but that the title of the bank was defective. The

> sale was a cash transaction, in which the passage of title depended on payment; and it is well settled that, in absence of special agreement to the contrary, a check is conditional payment only and does not operate to effect payment unless it is itself paid (Citing Federal cases here omitted). The rule that a check of the debtor is merely conditional payment applies to obligations arising out of immediate transactions, as well as to payment of antecedent debts; and, where there is a sale for cash on delivery, and payment is made by check of the buyer, such constitutes only conditional payment. Until the check is itself paid, the title, as between the parties, passes only conditionally; and, upon dishonor of the check, the seller may rescind the transaction and reclaim that with which he has parted." (Citing Federal cases here omitted).

That the proposition for which appellee contends is not only the Washington and Federal rule but the rule adopted by courts generally, see *(J. W. Young v. Harris Cortner Company et al*, 152 Tenn. 15, 268 S. W. 125, 54 A. L. R. 516, and Anno. 54 A. L. R. 526). (See also Anno. 31 A. L. R. 578-581) (46 Am. Jur. "Sales" Sec. 564 p. 708).

In contradistinction to appellant's position, it is noted that Mr. Williston on Sales also recognizes this rule. See the Young case *(supra)* at pages 518-519 (pages reference to A. L. R.)

> "Upon principle we are unable to distinguish the instant cause from that of a sale made over a counter where the seller was induced to accept a check as cash. Such transactions are treated by the authorities as conditional sales, the title not passing until the condition (the payment of the check) is complied with, or, as stated by Mr.

Williston, the purchaser only has a contract right until the price is paid."

(In the Young case, *supra*, the cotton sold was represented by a negotiable warehouse receipt and Tennessee has adopted the Uniform Sales and Negotiable Warehouse Receipts Acts).

III.

Where a seller accepts payment of goods by a check dishonored on presentation, the seller may either recover the proceeds of the sale or retake the property from a trustee in bankruptcy of the buyer for the reason:

(a) Payment by check is required by commercial necessity to be a conditional payment.

(b) Title to the goods does not pass until the check is paid.

(c) General creditors have no legal or moral right to the property so acquired as no consideration flows to seller until payment of the check.

(d) Relinquishment of seller's right to retake the property creates a present consideration for the subsequent payment of a dishonored check.

The rule above as contended for by appellee has so long been the rule adopted by Federal Courts that the proposition for many years has not been seriously disputed.

The rule is adhered to and followed by the Federal Court in the following cases:

In Re A. O. Brown & Co., 189 Fed. 442.

In Re Perpall, 256 Fed. 758.

Marion Mach. Foundry v. Giraud, 285 Fed. 160.

Hough v. Atchison T. & S. F. Ry. Co., 34 Fed. (2d) 238.

In Re Z. J. Fort-Tidwell Co., 34 Fed. (2d) 238

In each of the above cited cases the check received as payment was dishonored on presentation (Note sight draft in *Hough case* treated as worthless check).

The writer will quote at length from the *Hough case, supra,* but will first adopt the language of the annotator appearing in 31 A. L. R. 586,

> "Where the buyer of goods pays for the same by check, which is not paid, the seller may retake the goods or recover the proceeds thereof from the trustee in bankruptcy. *Re Perpall* (1919) 168 C. C. A. 104, 256 Fed. 758."
>
> "As between the trustee in bankruptcy of the buyer and the seller, actual fraud in inducing the seller to deliver the goods need not be shown; it is sufficient in this regard if the sale was made upon condition, which was never performed. The fact that the seller accepted a check which was never paid does not affect his right to claim goods delivered under the belief that the check would be paid, although given in payment of other goods, payment being a condition to delivery. *Marion Mach. Foundary & Supply Co. v. Giraud* (1922) 285 Fed. 160."

In the *Hough case, supra,* the court treated the sight drafts as worthless checks. The court at page 240 recognizes the fact that checks are the usual method of consummating cash transactions of this kind and points out that the "preference" must be at the expense of the other creditors before it is voidable.

> "Again, the Bankrupt Law undertakes to prevent one creditor from obtaining a preference at the *expense* of other creditors in like situation. 'Cash transactions are not within the prohibition.' *Remington on Bankruptcy* (3d Ed.) Sec. 1695. The use of checks or their equivalent

is the accepted method of consummating cash transactions of this size."

Continuing in the language of the Court:

"*In re Perpall*, 256 F. 758. And in another case of the same title (271 F. 466) the same court declined to require a *creditor* to pay back to the trustee the proceeds of a check which he had received for the purchase price of bonds, notwithstanding the fact that the check was received and paid after the filing of the petition in bankruptcy, and notwithstanding the fact that some hours elapsed between the delivery of the bonds and the receipt of the check. It was held that the entire matter was a cash transaction, notwithstanding the use of checks instead of currency, and notwithstanding the lapse of a short period of time between the delivery of the bonds and the receipt of the check."

In referring to *Illinois Parlor Frame Co. v. Goldman*, 257 Fed. 300 (7 C. C. A.) where the right to rescind a contract of sale arose out of a fraudulent sale, the Tenth Circuit Court speaking in the *Hough case, supra*, said:

"But on June 9th appellant concededly had a right to rescind the fraudulent sales and to recover back such of the goods as were then in the bankrupt's possession. Clearly a return of these goods would not be a preference; to the extent of their value, payment could no more effectuate a preference; neither transaction would diminish the estate to which the bankrupt was entitled. That appellant did not expressly assert a right of rescission is immaterial; it relinquished that right in confirming the sale; it then gave up a property interest equal to the value of the goods then on hand. To that extent the transfer was for a present consideration, and not preferential."

Just as clearly the return of the warehouse receipt or the payment of the check delivered to Benzel could not work a preference as Chemurgy's estate would not be diminished thereby.

The court in the *Hough case* held that a preference does not arise where seller recovered goods obtained by giving a worthless check.

> "*Mulroney Mfg. Co. v. Weeks*, 185 Iowa, 714, 171 N. W. 36, it was held that where a bankrupt secured possession of goods by giving a worthless check, the recovery of the goods does not constitute a preference. To the same general effect, see Manly v. Ohio Shoe Co., (4 C. C. A) 25 F. (2d) 384, 59 A. L. R. 413, In re Weissman (2 C. A. A.) 19 F. (2d) 769, 51 A. L. R. 644 * *"

The general creditors of Chemurgy were not injured in any way by the payment of the check in question. The relative rights of the parties is clearly expressed in the language of the *Hough case, supra.*

> "In the case at bar, the possession of the freight was procured by the giving of sight drafts which were dishonored on presentation. The railway company had a right to recover the possession so wrongfully obtained. Such recovery would not have diminished the estate to which the creditors are rightfully entitled, nor constitute a preference. Accepting payment of the draft, in lieu of recovery of the goods, is not a recoverable preference. From whatever angle you may look at it, one fact stands out: The bankrupt procured possession of this crate material by giving the equivalent of worthless check. The creditors have no legal or moral right to the crate material, or its sale price, without paying the freight."

From whatever angle we view the transaction in question Chemurgy gained possession of the warehouse receipt by giving a worthless check therefor and the creditors have no moral or legal right to retain the wheat without paying therefor.

It is unconscionable that the trustee attempts to gain a benefit growing out of the giving of a worthless check and the fraudulent acts of the buyer.

The balance of this brief will be devoted to answering appellant and summary.

It is not difficult for appellant to make a plausible argument based on the implausible conclusion that the sale in question was a sale on credit.

Appellant does not cite one case in which the trustee in bankruptcy was permitted to retain property procured by issuance of a worthless check; nor does appellant submit one case in which the trustee was permitted to recover the proceeds of a dishonored check from a seller and yet retain the seller's property.

It is significant that in all cases cited by the appellant, the sale was either a sale on credit or the check was given in payment of an antecedent debt.

In *Seattle Assn. of Credit Men as Assignee v. P. D. Luster*, 137 Wash. Dec. 181 (1950) 222 Pac. (2d) 843 cited by appellant as the cornerstone of his argument was an action in which credit was extended by the

seller to the buyer as shown at page 182 (Wash. Dec.):

> "The buyer informed seller in writing: 'We are also submitting our check for the balance *with the distinct understanding that this check is to be held until the customer has paid for this shipment in full.*' "

The checks of the buyer could not be presented for payment by the seller until the subpurchaser had paid buyer in full.

The language of the cited case, referring to *Stern v. Lone*, 32 Wn. (2d) 785, 203 Pac. (2d) 1074, explodes appellant's theory, however, to the effect that the mere cashing of a check within the four-month prohibitionary period works a preference.

> "But this is only true, of course, if the checks are cashed in payment of an antecedent debt. Before a preference may arise, a transfer of *debtor's property* must result in a diminution of the estate available for his other creditors."

The writer has no quarrel with the result arrived at in *Seattle Assn. of Credit Men, supra.* The seller there by voluntary agreement extended the time of payment and thus extended credit to the buyer. More than that, however, the seller could not claim payment until the property was sold to a subpurchaser and then only after the proceeds of such sale to the subpurchaser had been paid over to the account of the buyer. Under the facts no other result should obtain.

Seattle Assn. of Credit Men v. Daniels, 15 Wn. (2d) 393, 130 Pac. (2d) 892, cited by appellant, was not a sales contract, but one for work and service in which credit was extended. The claimant could not demand payment nor was payment required to be made until receipted bills and payroll had been presented, audited and ordered paid. Under the facts there was an extension of credit and payment of a pre-existing indebtedness.

In *Stern v. Lone*, 32 Wn. (2d) 785, 203 P. (2d) 1074, cited by appellant neither party claimed the transaction was a cash sale.

In *Seattle Assn. of Credit Men v. Hudson Mach. Co.*, 135 Wash. Dec. 643 (1950) 214 Pac. (2d) 681, there was a voluntary extension of credit. Seller was one of a number of general unsecured creditors who had extended credit to the insolvent. That the seller was an unsecured creditor is admitted. "Respondent acknowledges that it is an unsecured creditor."

Although appellant argues to the contrary, the warehouse receipt in question, as between the original parties was nothing more than a simple contract in writing and subject to all the defenses both at law and equity existing in the original parties. (See *Vancouver National Bank v. Katz*, 142 Wash. 306, 252 Pac. 934).

Neither was Chemurgy a holder in due course and

a negotiable instrument is subject to same defenses as if it were non-negotiable in the hands of a holder other than a holder in due course *(Rem. Rev. Stat. of Wash.* § 3449). Lack of consideration is a matter of defense *(Rem. Rev. Stat. of Wash.* § 3419) and as between the parties it may be shown that delivery was conditional *(Rem. Rev. Stat. of Wash.* § 3407).

As has been previously demonstrated the courts hold that the acceptance of a check is merely a conditional payment and that in cash sales the delivery of goods and the payment therefor are concurrent and mutually dependent conditions. Any argument to the contrary suggests that Chemurgy can gain greater rights out of the issuance of a worthless check than one paid on presentation for it is admitted by appellant that no preference would be claimed had the check been paid on presentation. Chemurgy, by the acts of its agents, cannot make Benzel its involuntary creditor by issuing him worthless paper.

SUMMARY

The facts reveal that Snyder representing Benzel and Whitmore representing Chemurgy entered into an agreement for the cash sale of wheat. Snyder had no authority to sell the wheat except for cash. The delivery of the wheat receipts and the check in payment thereof were concurrent and mutually dependent acts. The sale was made in the ordinary

course of business and the checks and receipts delivered through channels selected by the buyer. The check was accepted as means of payment and title to the wheat did not become absolute in the buyer until the check was paid. Benzel had the right upon dishonor of the check to retake the property or to recover the proceeds of the sale. Benzel elected to recover the proceeds of the sale rather than retake the property. The waiver of the right to Benzel to retake the property is a sufficient present consideration passing to the creditors for the recovery of the proceeds of the sale. That the creditors have no moral or legal right to obtain something for nothing and that in such case Benzel could recover from the trustee in bankruptcy if he did not already have possession of the proceeds of the sale.

Appellee submits that under both the law and the facts that the judgment of the District Court should be affirmed.

Respectfully submitted,

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Attorney for Appellee

No. 12734

United States Court of Appeals

For the Ninth Circuit

ADOLPH W. ENGSTROM, Trustee in Bankruptcy for Northwest Chemurgy Cooperative, a corporation, Bankrupt, *Appellant,*

vs.

ARTHUR BENZEL *Appellee.*

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

APPELLANT'S REPLY BRIEF

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Appellee purports to restate the facts and in doing so simply selects a few portions of the Agreed Statement or of the Findings which he deems favorable to his contentions. The pertinent portions of the Agreed Statement and Findings are brief, and appellant submits that a much fairer idea of the facts can be obtained from a reading of the District Court's Findings as *quoted* in appellant's brief, pp. 7, 8 or the Agreed Statement (Tr. 12-15). One result of this suggested approach will demonstrate that the District Court did not adopt "appellee's version of the transaction in question" (Appellee's br., p. 3). As a matter of fact, the Court expressly found against appellee on one of the basic points in appellee's argument, i.e., the contention that title did not pass when the warehouse receipt was delivered on January 3rd, 1947. On this issue the Court found against appellee. Finding II states:

> "On or about January 3rd, 1947, the defendant Arthur Benzel, by endorsing and delivering to Northwest Chemurgy Cooperative a negotiable warehouse receipt covering 1,000 bushels of wheat, *sold and delivered said wheat to said corporation* at the agreed net price, after deducting charges for handling, insurance and storage $72.50, of $6927.50" (Tr. 25). (Emphasis supplied.)

The Agreed Statement shows some discrepancy between the parties solely as to the initial conversation between the agents of the parties. However, in view of the basic principles of construction of the preference statute (set out below) the controlling facts are not what the parties said *but what they actually did and what actually happened.*

Before responding directly to each of appellee's contentions appellant therefore again refers to certain of the salient principles announced by the Supreme Court of the State of Washington in the construction of the preference statute here involved:

SUMMARY OF SALIENT PRINCIPLES OF CONSTRUCTION OF PREFERENCE STATUTE

1. There is a definite cutoff date represented by the beginning of the four months' period,

> "Whatever may have been the law prior to the enactment of the state Preference Act in ~~1914~~ 1941, the legislature has now provided with respect to pre-~~enactment of the state Preference Act in 1941, the~~ ference payments made in discharge of unsecured credits, a definite cutoff date, represented by the beginning of the four months' period." *Seattle Ass'n of Credit Men v. Hudson Machinery Co.* 135 Wash. Dec. 643 (1950) 214 P.(2d) 681.

2. Absent a claim of priority or statutory lien *or security by agreement of the parties* all inquiry regarding the status of a preferential payment is limited to what takes place within the four months' period,

> "There may be inquiry beyond that date (beginning of the four months' period) with respect to any claim that a preference represents payment of a credit which has priority or lien protection under statute, or which is secured by agreement of the parties. But absent such a claim, all inquiry regarding the status of a preference is limited to what took place within the four months' period. * * * But credits received by the insolvent from the creditor prior to the four months' period, unless enjoying statutory priority or secured in some manner, may not be set off or taken into consideration in any other way, whether or not the insolvent made a profit on the transaction." (Portion in parenthesis supplied). *Seattle Ass'n of Credit Men v. Hudson Machinery Co.* 135 Wash. Dec. 643 (1950) 214 P.(2d) 681.

3. In construing an alleged preferential transaction the court is not concerned with when "payment" is received, but rather with whether or not the property of the corporation was diminished by the alleged preferential transfer,

> "We are, of course, not here concerned with what constitutes payment with respect to the statute of frauds, nor are we primarily concerned with the date when Lone received 'payment' for his corn. Our statutory definition of 'preference' quoted earlier in this opinion, contemplates two kinds of preferences: (1) suffering a judgment,

and (2) a transfer of any of the property of the corporation. No judgment is involved in this case. We are primarily concerned here with whether or not the property of the corporation was diminished by a transfer of corporate property to Lone, and if so was a transfer made more than four months before May 1947, or within that four months. *In deciding the question before us, the word 'transfer' is the key word, not 'payment'.*" (emphasis supplied). *Stern v. Lone,* 32 Wn.(2d) 785, 203 P.(2d) 1074.

4. A preferential transfer occurs when a check is cashed, not when it is delivered,

> "It seems clear to us that no transfer of property was made by the delivery of the check . . . It was when the check was cashed that corporate assets were transferred and a preference made." *Stern v. Lone* 32 Wn.(2d) 785, 203 P.(2d) 1074.

5. The intention of the parties as to whether they intended the extension of credit in the transaction which gives rise to the preferential transfer is immaterial,

> "That the parties did not regard nor intend the transaction as an extension of credit, makes the payment none the less a preference." *Seattle Ass'n of Credit Men v. Daniels,* 15 Wn.(2d) 393, 130 P.(2d) 892.

Having the foregoing principles, and the others set forth in appellant's Opening Brief, in mind, we turn now to consideration of the contentions set forth in appellee's Answer Brief.

APPELLEE'S INTRODUCTORY STATEMENT

1. The transaction was not a cash transaction. On the facts Whitemore denied that it was to be a cash transaction (Tr. 13). The facts sustain Whitemore. Williston defines a cash transaction as a sale wherein the seller "declines to transfer either title or right to possession until he is paid" 2 Williston on Sales (Rev. Ed.) 324, §341. The Court found that the wheat was sold and delivered on January 3rd, 1947—appellee was not paid until February 3rd, 1947. Appellee made no effort to suspend title until he was paid. If appellee had intended that title not vest until after he was paid, he would have placed the negotiable warehouse receipt in escrow or sent it to the bank for delivery upon payment to his account, or one of several other alternative methods of obtaining actual payment prior to or at the time of delivery of the negotiable warehouse receipt which vested title. The letter transmitting the warehouse receipt (Ex. A, Tr. 16-17) did so with no reservations, and by the postscript recognized that a check would not be mailed until after the warehouse receipt was received by Chemurgy.

The seller did not accept a check delivered or dated the same day as the delivery of the wheat. *The check he received and accepted was issued, dated and received ten days after he had unconditionally delivered the wheat. These basic facts in themselves completely distinguish the facts of this case from all of the cases relied upon by appellee,* since in appellee's cases delivery of title was usually induced by the delivery of a check dated and delivered on the day the property involved was delivered.

Furthermore, appellee held the check for four days before he even deposited it for collection (Tr. 14)—a further indication that payment was not a condition precedent to the passing of title. Chemurgy was in the business of manufacturing wheat into glucose and it cannot be inferred under the facts of this case that it was restrained from using the wheat purchased from Benzel until such time as appellee condescended to pass title to the wheat by the cashing of Chemurgy's check.

2. *The principle that payment by check suspends the passing of title and that upon non-payment of the check the property can be reclaimed (where the interests of creditors are involved) is not the law in Washington—Goodwin v. Bear,* 122 Wash. 49, 209 Pac. 1080.

Even where the principle is applied it is invoked only in true *cash sales*—and this transaction was not a *cash sale.*

As shown later in this brief under the reply to appellee's contention III, even if appellee had a right at one time to reclaim the wheat (which is not conceded) he waived such remedy prior to the four months' period and chose to look to Chemurgy as his debtor.

The sole ultimate question is whether the property of an insolvent corporation was diminished on February 3rd, 1947, *when money was paid out of its bank account to appellee.* Under the law applicable to the facts of this case on February 3rd, 1947, appellee had no more than a general claim against Chemurgy in the amount of the net price of the wheat and when this claim was paid the property of the insolvent was of course diminished by the amount of said payment.

I.

Appellee contends (Appellee's br., p. 7):

In the absence of an agreement to the contrary it is presumed that a sale of personal property is a cash sale.

Appellant has shown at pages 21 to 32 of the Opening Brief that the transaction here involved was not a "cash sale."

There is no room for *presumptions* in this case as to the vesting of title. The *statutes* under which title vested in Chemurgy are quoted on pages 22 and 23 of appellant's opening brief.

These statutes are, of course, by their terms applicable to endorsements and deliveries of warehouse receipts between the immediate parties. At pages 19 and 20 of his brief appellee cites certain sections of the Washington statutes with respect to bills and notes (R.R.S. 3449, 3419 and 3407) which have no relevance to the statutes quoted on page 22 of appellant's brief. Lest there be any suggestion that the warehouse receipt statutes are not given full effect between the immediate parties we refer to the case of *Klock Produce Co. v. Diamond Ice & Storage Co.,* 90 Wash. 67, 155 Pac. 414, in which it was contended that Rem. Rev. Stat. 3616 requiring endorsement upon the negotiable receipt of charges for storage subsequent to the date of the receipt was not applicable to the original parties to the receipt. The Supreme Court in refusing to follow this argument stated in part:

> "Finally it is argued that, granting that Section 30 (Rem. Rev. Stat. 3616) forbids belated surcharging of a negotiable receipt, the statute really was

looking to the protection of third parties, and that in this suit between original parties the court should give the warehouseman this surcharge. Such doctrine, often tempting to courts, generally lead, though, to embarrassment. If we should let the rule vary in this way we should justify endless contentions as to whether a receipt alleged to be transferred was transferred in good faith, whether the assignment was in legal form, whether the warehouseman had actual notice of it when it was not in legal form, whether the transfer was for value, together with many other contentions that would frequently expose true transferees to loss on technical grounds or put them to laborious proofs which, if we let this statute speak for itself, the paper in his hands would spare him."

"The statute itself is simple. It will cause no hardship on the warehouseman or anybody if let alone * * * The policy of the law was to make negotiable receipts useful in the highest degree."

Following these statutes, the cases all hold that title is transferred immediately upon endorsement and delivery of a negotiable warehouse receipt. Representative quotations are as follows:

"The indorsement of the warehouse certificates to the bank transferred the legal title to the wheat and products which they represented. The warehouse certificates so read, the statutes of Iowa so provide, and such is the general law in the absence of statute. Section 3138a41, 1913 Supp. to Code of Iowa; *Gibson v. Stevens,* 8 How. 383, 12 L.ed. 1123; *Dale v. Pattison,* 234 U.S. 399, 34 Sup. Ct. 785, 58 L.ed. 1370, 52 L.R.A. (N.S.) 754." *Central State Bank v. McFarlin,* 257 Fed. 535, 537.

> "When the appellant became the holder of the receipt for the cotton it acquired such title to the cotton as the person negotiating the receipts to it had the ability to convey and it became the appellee's duty to hold possession of the cotton for him 'as fully as if' it 'had contracted directly with him'. §41, C. 218, Laws of 1920 (Hemingway's Supplement of 1921, §7957 ol)" *Love v. People's Compress Co.* (Miss.), 102 So. 275.

Title was therefore, by virtue of the endorsement and delivery of the warehouse receipt and the applicable statutes of the State of Washington immediately vested in Chemurgy. An examination of all of the cases cited by defendant will show that in none of them was a negotiable document of title involved as to which there was a controlling statute mandatorily transferring title upon endorsement and delivery of the document of title. Since this last statement is applicable to every case cited by defendant and effectually distinguishes every one of defendant's cases from the one here before the court, we will not discuss separately the cases cited by defendant which are therefore not in point and not controlling here. The distinction, for instance, is emphasized in the case of *Quality Shingle Co. v. Old Oregon L. & S. Co.,* 110 Wash. 60 187 Pac. 705, in which the court makes much of the fact that the transfer to the defendant was by *non-negotiable* bill of lading which by statute was specifically subject to existing equities. There is no such limitation on the statutes above quoted applicable to the endorsement and delivery here involved and the *Klock* case above referred to amply demonstrates that the statutes are to be strictly applied in accordance with their terms.

It is obvious that whenever a suspension of title in a sale occurs when the parties have not spoken of the point, it is done as an inference of law where there is no statute governing the situation. However, in this case we have express statutes under which title vested immediately upon the endorsement and delivery of the warehouse receipt. It is therefore pointless to consider cases as authoritative here which do not involve and are not controlled by statute. Since title vested on January 3rd, 1947, and payment was not made until February 3rd, 1947 (or within the four months' period), it is obvious that during said period Chemurgy owed defendant for the wheat and since money was owed to him he was, of course, a creditor.

In support of this contention appellee also cites Rem. Rev. Stat. §5836-42 (Appellee's br., p. 8). But this statute is expressly on the premise:

> "Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions;"

It has already been pointed out that delivery of the goods and payment were not to be concurrent in this case. The Court found the property was sold and delivered on January 3rd, 1947. The check was not to be delivered until after title had been conveyed to Chemurgy (See postscript to Ex. A, Tr. 16-17). The discussion between the agents of the parties is immaterial—reference to a cash sale does not make the agreed acts a cash sale.

The case of *Gustafson v. Equitable Loan Association,* 186 Minn. 236, 243 N.W.106, cited by appellee (p. 9)

is not relevant. This was a replevin case arising only on demurrer. The court held that under the pleadings title to the property involved did not pass. Under the Washington statutes quoted on page 22 of the Opening Brief title did pass in the present case. In the *Gustafson* case the court clearly indicated that its result would have been different if title had passed. The court stated:

> "Defendant argues that plaintiff waived the cash payment by voluntarily delivering the diamond and hence title passed to Madden. *In many cases such a question may be one of fact but upon the record before us the contention is untenable;* the pleading is definite; that is all we have." (Emphasis supplied.)

In the present case title passed on January 3rd, 1947, not only as a matter of fact, but also as a matter of statutory law.

The point that this was not a cash sale is discussed on pages 21 to 33 of the Opening Brief.

II.

Appellee contends (appellant's br. p. 10):

> *Upon a cash sale payment by check is conditional only and between the immediate parties title in the buyer does not become absolute until the check is paid.*

In support of this proposition appellee cites *Quality Shingle Co. v. Old Oregon Lumber & Shingle Co.,* 110 Wash. 60, 187 Pac. 705; *Standard Investment Co. v. Town of Snowhill* (N.C.) 78 F.(2d) 33 and *J. W. Young v. Harris Cortner Co.,* 152 Tenn. 15, 268 S.W. 125.

The *Quality Shingle Co.* case is not in point, but if deemed to be, it has been in effect over-ruled by a later Washington case hereinafter referred to. In the *Quality Shingle* case the court relies upon the *express representation* to the seller that the check would be paid upon presentation. On this basis the court stated:

> "It seems to us to follow in the light of elementary rules of law that as between respondent and Shepard-Traill Co. the title to the shingles did not pass from respondent to Shepard-Traill Co. upon it receiving the bill of lading for the shingles and giving its check to respondent therefor."

The case is irrelevant here because there was no false representation in the present case and because the District Court by its findings found that the wheat had been "sold and delivered to Chemurgy" (Tr. 21).

The later case of *Goodwin v. Bear,* 122 Wash. 49, 209 Pac. 1080 demonstrates that it is not the rule in Washington (and therefore not the rule of this case) that title is suspended pending the payment of a purchase price check. In that case the appellant sold 12 cows to one Tarry. By agreement the cows remained on appellant's farm until Tarry wanted them. Six days later Tarry gave appellant his check for the balance of the purchase price and two days later Tarry took the cows from appellant. Appellant kept the check four days and then deposited it for collection. Before the check was paid by Tarry's bank the respondent, Central Bank & Trust Company, seized the cattle under an execution upon a judgment against Tarry. Tarry then stopped payment on the check and through his agent advised appellant that he should make claim for the cattle. Ap-

pellant brought this action in replevin. The trial court held that title passed at the time of the original purchase on August 17, 1921, and rendered judgment against appellant. Appellant contended that a check cannot be considered as payment untill it is made good and cited cases holding that a worthless check is not in fact payment and that goods so obtained can be reclaimed. The court, in affirming the trial court and repudiating the appellant's contention stated:

> "There is no evidence in this case indicating that the check was not drawn against sufficient funds and the evidence further shows that the parties intended a completed sale on August 17. *If appellant intended to keep the possession of the cattle as security for his final payment he lost his right to a lien when he permitted the cattle to be taken from the premises and thus surrendered his possession.* His delay of four days in presenting his check prevented it being paid in the ordinary course of business and if he were permitted to prevail in this action he would carry into effect the apparent effort of Tarry to defraud his creditor, the respondent bank."

Applying the foregoing case to the present case it shows the irrelevancy of appellee's worthless check cases, demonstrates further the title to the wheat here involved passes on January 3, 1947, when it was delivered and also demonstrates that appellee's delay in presenting his check cannot be used to defeat the obvious application of the Washington Preference Statute in favor of Chemurgy's creditors. It will be remembered in the present case (Tr. 14) that Benzel also waited four days to deposit his check. There is no evidence that the funds

of Chemurgy were insufficient when the check was delivered or during the days in which Benzel delayed in depositing it. The case of *In re A. O. Brown & Co.,* 189 Fed. 442 (cited by appellee, p. 13) demonstrates that the non-payment of a check does not indicate fraud where a period of time (as in the present case) must necessarily elapse between the mailing of a check and its presentation for payment. The court stated:

> "It is doubtless the custom to deposit checks and so to take 24 hours to cash them, and, if that were a part of the engagement so that the check could not be presented for payment except at the end of 24 hours, then the check would properly be held to be a time draft; and, though the time would be short, it would be also quite proper to hold that to give the check was no more than a representation that at the end of 24 hours the drawee would be in funds. *Were that the fact, it would be impossible to show fraud or a misrepresentation of fact without showing that the drawer did not intend to put the drawee in funds when he uttered the check.*" (Emphasis supplied.)

The court in the *Brown* case also expressed disapproval of those cases which hold that delivery by a seller upon a cash sale (assuming solely for the purpose of argument that a cash sale was made in the instant case) is not of itself a waiver of the condition of payment. The court stated:

> "In the other cases the rule seems to be confused with the rule which exists in many jurisdictions that delivery by a seller upon cash sale is not of itself a waiver of the condition of payment. *I believe that this rule is quite wrong in principle*

(Williston on Sales, §346); nor is there any authority binding upon me. *At least such a delivery must be held to be presumptive evidence of waiver and this appears to be the rule in New York. Osborn v. Gantz,* 60 N.Y. 540." (Emphasis supplied.)

Williston also is very critical of the cases which hold that vesting of title is conditional until a check representing the purchase price is paid. Williston states:

"It is submitted that such decisions are unsound. The reasoning upon which they rest is that a worthless check is no payment of the price, and the condition has not happened upon which the property was to pass. *But the real question is, did the seller assent to transfer the ownership in the goods; and it can hardly be doubted that he did.* If it were true as is often stated, that the fact that the check is given merely in conditional payment proves that no title passes until the condition is satisfied, the same consequence would follow if a time draft were given instead of a check. *Such a result would obviously be absurd. It would also follow that where a check was given and there were funds to meet it, no title would pass until the check was paid,* for a good check as well as a bad check is generally held only conditional payment. *There is confusion of thought in supposing that the condition in conditional payment by means of negotiable paper has any reference to the ownership of property given in exchange for the paper.* The condition relates to the creditor's right to revert to the money claim for which the negotiable paper was given. If a seller should say, 'you must not deal with these goods, though I have put them in your hands, until I collect the check,' *that* would show an intent not to transfer the property to the buyer. *But when the*

goods are put into the buyer's hands without more, it can hardly be doubted that the seller means to allow him to deal with them as his own; to resell them immediately if he feels inclined. If no title passed until the check was paid the buyer would be a tort feasor if he used the goods until the check was paid, even though there were ample funds in the bank to make the payment." * * *

"A delivery to the buyer with authority to use the goods immediately should be conclusive evidence of transfer of the property in the absence of clear evidence, showing an intention to reserve the title." 2 Williston on Sales, Revised Ed. 346 (a) and 346 (b).

As shown above in the *Bear* case the Washington court, in line with Williston's comments, holds that after possession is given title is not suspended pending the payment of a purchase money check.

The case of *Standard Investment Co. v. Town of Snowhill* (N.C.) 78 F.(2d) 33, (cited by appellee, p. 11) holds that title does pass subject only to a right of recision if the check is not paid. The court stated:

"Until the check is itself paid, the title as between the parties, passes only conditionally; and upon dishonor of the check, the seller may rescind the transaction and reclaim that with which he has parted."

The case of *Young v. Harris Cortner Company,* 152 Tenn. 15, 268 S.W. 125, (cited by appellee, p. 12) is also not in point on the facts because in that case a check was delivered immediately at the time of delivery of the cotton there involved and the court held that:

"Upon principle we are unable to distinguish

> the instant cause from that of a sale made over a counter where the seller was induced to accept a check as cash."

In the instant case the wheat was delivered under circumstances clearly demonstrating that a check was not to be given until sometime later and after computations had been made to arrive at the net price. The *Young* case also relied upon the doctrine that in such cash sales title does not pass, which doctrine is criticized by Williston as set forth above, and not followed in Washington as shown by the *Bear* case reviewed above. Appellee at page 13 refers to the fact that the sales in the *Young* case were represented by negotiable warehouse receipts but appellee fails to point out that the court held the receipts *not negotiable* because of falsehoods appearing thereon. The court stated:

> "They are not in a position therefore to rely upon said receipt because it speaks a falsehood of which they had knowledge" (The falsehood was that wheat had not been deposited when the receipts were issued.)

The statute quoted by appellant (Appellant's Brief p. 22) applies to *negotiable* warehouse receipts.

III.

Appellee contends (appellee's br. p. 13):

"Where a seller accepts payment of goods by a check dishonored on presentation, the seller may either recover the proceeds of the sale or retake the property from a trustee in bankruptcy of the buyer."

This contention is in no event applicable in this case because of the express holding of the Supreme Court of

the State of Washington in construing the preference statute (which construction is, of course, binding in this case) that every payment out of the funds of an insolvent corporation during the four months period is deemed a preference *unless paid on a claim having priority, or a claim having lien protection under a statute, or a claim which is secured by agreement of the parties*:

> "There may be inquiry beyond that date (beginning of the four months period) with respect to any claim that a preference represents payment of a credit which has priority or lien protection under statute or which is secured by agreement of the parties. But absent such a claim all inquiry regarding the status of a preference is limited to what took place within the four months period." *Seattle Association of Credit Men v. Hudson Machinery Co.,* 135 Wash. Dec. 643, (1950) 214 P.(2d) 681.

The alleged right of the appellee could not, of course, under any circumstances qualify under the foregoing quotation as a prior claim or a statutory lien claim or a claim "*secured by agreement.*" Furthermore, the doctrine of the cases listed on page 13 of appellee's brief is in any event only applicable in *cash sales* where the passing of title is conditioned upon the payment of the purchase price.

There are good reasons for the Washington court's construction as aforesaid of the preference statute.

The law abhors secret liens or rights. If this court were to find that this was *a conditional sale,* and give effect to such agreement on any theory, the court would be upholding a secret lien or right and would, at the

same time, destroy to a large extent the effectiveness of the preference act. If a party can "sell and deliver" property (Tr. 25) and *by inference* still retain secret rights therein which can be asserted as against representatives of all creditors, then he can do so by oral agreement, and as a result any creditor could make a deal with his insolvent debtor which would result in his getting a greater percentage of his debt than other creditors of the insolvent. To avoid the impact of the preference statute, the debtor and creditor, if appellee's position is sound, need only testify that they made a secret oral agreement which had the effect of reserving title and giving the creditor preferred status. The impossibility of meeting such evidence is obvious. Appellee here attempts to *infer* a secret right, which should not be given effect, even if orally agreed upon.

The policy of the Federal Bankruptcy Act, to which the Washington court has made frequent reference (*Seattle Ass'n of Credit Men v. Hudson Machinery Co.* 135 Wash. Dec. 643, 214 P.(2d) 681) is to require creditors to use orthodox methods of establishing and retaining legal rights and liens (Chap. 70, Public Law, 461, U. S. Code Cong. Service, 1950, page 185). The purpose of §60-A,(6), the section promulgating the aforesaid policy is:

> "To make it certain that the amendment (to the Federal Bankruptcy Act giving greater security to power of sales security transactions) will not validate, in the hands of a secured creditor, equitable liens where available means of proving legal liens have not been employed by him." U.S. Code Cong. Service 1950, House Report No. 1293, P. 263, 267. (Parenthetical portion supplied)

The State of Washington requires the recording of conditional sales, Rem. Rev. Stat. § 3790.

We have already shown at pages 21 to 32 of the opening brief that the transaction here involved was not a "cash sale."

Assuming, however, simply for the purposes of the argument, that title to the wheat was originally only conditional and that originally appellee had a right to reclaim the wheat, still under well settled and leading authority title vested unconditionally without right of any reclamation because appellee failed to act promptly upon breach of the conditions upon which he relies.

Title vests even when a sale is on condition unless the seller acts promptly upon breach of condition and further vests whenever there is a failure of initial payment and possession is allowed to be retained upon a new promise to pay.

A leading case on this point is *Frech v. Lewis,* 218 Pa. 141, 67 Atl. 45 involving the sale of two carriages to be paid for on delivery. Payment was not made on delivery and seller did not promptly move to reclaim the property. In an action of replevin to regain possession the court found for the defendant on the ground that title had unconditionally passed without right of reclamation. The court stated:

> "Possession, however, having passed, and the buyer, by the act of the seller, having been invested with the indicia of ownership, the policy of our law requires that this situation—the possession in one and the right of property in another—shall continue no longer than is necessary to enable the seller

to recover the goods with which he has parted. The law gives the seller the right, in such case, to reclaim his goods; but he must do so promptly; otherwise he will be held to have waived his right, and can only thereafter look to the buyer for the price. The question the present case suggests is: When does this inference of waiver arise? Our authorities admit of but one answer: Except when delayed by trick or artifice, *the assertion of the right to reclaim the property must follow immediately upon the buyer's default.* This does not mean that the seller must eo instanti begin legal proceedings to recover the goods; but it does mean that the seller, when he discovers that his delivery is not followed by payment, as he had the right to expect, *is at once put to his election whether he will waive the condition as to payment and allow the delivery to become absolute, or retake property;* and that he is to allow no unnecessary delay in making his choice. *The object of the law is not to multiply his remedies because of his disappointment. He may not continue to hold his right to the goods, and at the same time hold the buyer as his creditor. One or the other he must relinquish, and do it promptly, or the law will forfeit his right to elect. Continued acquiescence in the buyer's possession of the goods will be taken as a choice on his part to regard the delivery as absolute, notwithstanding the buyer's default.* The policy of the law, in requiring promptitude in the assertion of continued ownership of the goods, could easily be vindicated were it necessary. It answers every purpose here to show that the law requires it. In *Leedom v. Philips,* 1 Yeates, 527, it is said: 'When the parties specially agree, it is obvious that the vendor may, by his contract, renounce the benefit of the conditions stipulated, and trust to the good

faith of the vendee for a future performance on his part. If one sells goods for cash, and the vendee takes them away without payment of the money, the vendor should immediately reclaim them by pursuing the party; and he may justify the retaking of them by force.' This was quoted approvingly in *Bowen v. Burk,* 13 Pa. 146; and it was there added that, 'where he (the seller) lies by, and makes no complaint in a reasonable time, he consents to the absolute transfer of the property, and the contract is consequently complete against all the world.' In *Buckentoss v. Speicher,* 31 Pa. 324, reference is made to the case last above cited. What we have quoted from it was there approved, and the necessity for an immediate reclamation of the goods was emphasized. It is there said: 'This is the principle that is decisive against the present plaintiff. A sale of goods for cash is, strictly speaking, a sale on condition. The contract is do ut des. The condition is more imperative than such as was in this case, but for that reason, less easily waived; and yet if the vendor acquiesce in a possession obtained in disregard of the condition, he waives it, *and, though he may recover the price by action,* he cannot recover the goods in specie . . . When the plaintiff found his condition disregarded, he should have promptly reclaimed the goods.' *Mackaness v. Long,* 85 Pa. 158, is another recognition of the same doctrine that, unless reclamation of the property be made immediately, the title passes to the buyer. These cases and others that might be cited, following the lead of *Leedom v. Philips, supra, all hold that the duty is upon the seller, if he would retain his right to the property, to proceed promptly; and we know of no case in which a contrary doctrine is asserted.* In some cases the expression,

'within a reasonable time,' is used where the right to reclaim is referred to; but this expression suggests no departure from the rule as declared in *Leedom v. Philips, supra.* By 'reasonable time' is to be understood such promptitude as the situation of the parties and the circumstances of the case will allow. *It never means an indulgence in unnecessary delay, or in a delay occasioned by the vain hope and fruitless effort to obtain the money from the defaulting buyer. When the delay is to be accounted for by the latter consideration, it is accepted as an acquiescence in the delivery and the acceptance of the buyer as a debtor.*" * * *

"*The title to a chattel passes as fully after a conditional delivery, where possession is allowed to be retained in consideration of a new promise to pay, as where delivery is preceded by actual payment.* The plaintiff was not tricked into delivering the carriages to the defendant, nor was his delay in asserting claim to the property in consequence of any fraud practised. He reposed confidence in the promise of the defendant, and was disappointed. His disappointment does not restore to him the right of property with which he parted. The court below submitted it to the jury to determine whether plaintiff, by his conduct, had waived his right to retake the carriages. The jury found he had not, and gave the plaintiff a verdict for the property. On appeal to the superior court, the judgment of the lower court was affirmed. The ground on which the affirmance rested is thus stated by the learned judge who delivered the opinion: 'It cannot be said, as matter of law, that the plaintiff's conduct amounted to a waiver of his right. In view of the repeated promises of the defendant, the plaintiff might well have been misled and induced to post-

> pone proceedings for the recovery of his property. His delay is evidence . . . of a waiver, but it is not conclusive in view of the conduct of the defendant.' (32 Pa. Super. Ct. 282) In this we cannot concur. The reasons for our dissent fully appear in what we have already said. Reliance upon a subsequent promise to pay, that leads the seller to refrain from asserting his right to retake the property, is in itself a waiver of the right, and makes absolute a delivery which in the first instance was conditional. *The right of plaintiff to recover back his property after he had delivered it resulted from the buyer's failure to keep his first promise. His failure to keep subsequent promises to pay could neither prolong nor revive that right.* What defendant did or did not do is a matter that has no place in the inquiry; *what the plaintiff did or failed to do is the determining consideration.* (Emphasis supplied.)

It will be noted from the foregoing case that when the condition of the sale (here assumed to be for the purposes of argument, the prompt delivery of a check) is not met, the seller must move immediately to reclaim the property, otherwise the title vests. Title also vests for another reason, that is where the seller relies on a new promise to pay and certainly in this case the request to redeposit the check amounted to a new promise to pay by that procedure. This case is then in this respect like the *Frech* case just quoted, in that the seller instead of reclaiming his merchandise reposed confidence in the promise of the purchaser. The seller in this case is no different from the sellers of all of the merchandise who have been required in this bankruptcy proceeding to return the purchase price which they received under

the preference statute. They too were disappointed in that they were not paid and payment was deferred into the vital four months' period. The salient fact remains that possession vested in Chemurgy on January 3rd or 4th and it was not until a month later that Benzel was paid. During this interval he took no steps whatsoever to reclaim the possession, took no action because the check was not delivered immediately or because the check was not initially paid and under the well-settled principles enunciated in the foregoing *Frech* case must in any event be deemed to have vested title in Chemurgy on two grounds: (1) By failure to take any action when the check was not delivered as agreed and (2) When the check was not initially paid he did not attempt to reclaim the wheat but proceeded upon Chemurgy's promise that he would be paid and redeposited the check. A further circumstance of course is that Benzel held the check when he first received it for a period of four days before depositing it.

We here state (still assuming only for the purpose of the argument that title had not vested by virtue of the facts and the applicable statutes) that Benzel was put to an election earlier than the dishonoring of the check. The failure for a period of ten days to even receive the check was the breach of even an earlier, (in point of time of execution) agreement so far as performance was concerned and Benzel's taking and depositing the check, after holding it for four days, certainly indicates that he no longer relied upon any conditions but was satisfied with his confidence that he would ultimately be paid.

In *Guarantee Title & Trust Co. v. First National Bank* (3 C. C. A.) 185 Fed. 373 at p. 380, the court approves the doctrine of the *Frech* case and after quoting from the case states:

> "We do not think this view of the law is peculiar to Pennsylvania. It is reasonable, and accords with the practical conduct of human affairs. Delivery to the buyer may conveniently be made without insisting upon the concurrent payment of the price, if this right of reclamation to be promptly and reasonably exercised, is recognized in the seller. Such possession by the buyer, however, is very different in fact and in theory from the vendee's possession which accompanies a conditional sale. It may well be that the insertion by the Car Company, of the reservation of title until payment, in the invoice, was an appeal to and assertion of this right of reclamation, for its protection, after it had surrendered the goods to the possession of the vendee without having received the payment, as stipulated in the contract of sale. But this right of reclamation, as stated in the case just referred to, must be promptly asserted, or it will be considered as waived, and the seller is remitted to his rights against the buyer as his debtor. *Mackaness v. Long.* 85 Pa. 158, is another recognition of the same doctrine, that, unless reclamation of the property be made immediately, the title passes to the buyer. There can be no question, therefore, in the case at bar, that this right of reclamation existing in the Car Company when it allowed the goods sold to be delivered, without the payment it had a right to demand, to the vendee, has been lost by want of assertion during the long period that elapsed between the delivery of the goods and the bankruptcy of the vendee."

In *Cincinnati Railway Supply Co. v. Hartlieb et al.* (6 C. C. A.) 214 Fed. 177, the Circuit Court by per curiam decision, affirmed the District Court, which court quoted and followed the *Frech* case and stated in part:

> "But assuming that they could be traced, or even assuming that the actual goods were still in the hands of the trustee, it has been established by a long line of authorities that such a condition precedent may be waived by circumstances showing an intention to deliver notwithstanding the condition which could have been insisted on, *and to look to the vendee as a debtor only.*" * * *
>
> "The point is made that there was no consideration for the abandonment by the vendor of its initial right to repossess itself of its goods upon vendee's failure to comply with the condition of payment. It is significant that this question was not discussed in any of the numerous cases holding that the circumstances determine whether the vendor's initial right of retaking the goods has been abandoned by him. But the changed relation of the parties are not such as depend upon a new consideration, for the transaction is either one of conditional sale, if the vendor insists upon the condition, or an unconditional sale, depending upon his right to make it one or the other, at his election. *If he elects to waive his right of immediate payment, then the relation of debtor and creditor arises, a relation created by the voluntary act of the vendor and growing out of the voluntary abandonment of the right to treat the sale as conditional.* It is a matter of grace to the vendee involving the voluntary considerations and impulses which impel the making of a gift. *Besides, the vendor may prefer to treat*

> *the goods as sold and make his profit out of the sale rather than to take back the goods.* Indeed, this is exactly what happened in this case as all the facts show. That advantage to the vendor would be a consideration for his conduct in electing to treat the property as sold unconditionally. There is no room to doubt the correctness of the referee's conclusion under the circumstances of this case, and the petition for review will be dismissed at the intervener's costs." 214 Fed. 177, at p. 179. (Emphasis supplied.)

As pointed out in the foregoing quotation, upon the waiver of the condition the Seller becomes a "Creditor" and the Purchaser a "Debtor." The word "Creditor" as used in the Washington preference statute can certainly not be restricted to the narrow meaning attempted to be attributed to it by the defendant in his memorandum. Defendant would say that the only persons who may be considered "Creditors" under the preference statute are those who have specifically agreed that a debtor may have a period of time to pay. No such construction has ever been placed upon the preference doctrine in this state either before or after the enactment of the preference statutes. The word "Creditor" has a very broad meaning and certainly includes one to whom money is owned for any reason.

(See cases in appellant's opening brief, p. 14.)

Obviously in applying the term creditor as used in the preference statute there is absolutely no reason to distinguish between those who have obligations arising by reason of express contractural extensions of time to

pay and those who are simply entitled to be paid an amount for any reason. The gist of the preference statute is not the history of the obligation which is paid but rather that the assets of the corporation upon insolvency become a trust fund which cannot be paid to anyone to whom an obligation is owed.

A sample of the application of the preference doctrine to an instance where there is no extension of credit but simply an obligation implied by law is *Hill v. Brandes,* 1 Wn.(2d) 196, 95 P.(2d) 382, in which the indebtedness arose not out of the extension of credit but because the insolvent corporation had received money to which the defendant was entitled and later in recognition of this obligation made payments which were held to be preferential and recoverable by the receiver. The nature of the case is indicated by the following quotation from the syllabus:

> "Payments made by an insolvent corporation to a finance company constitute unlawful preferences, where the corporation sold automobiles under conditional sales contracts and sold and assigned the contracts to a finance company, and the customers later returned the automobiles to the corporation in trade for other cars and transferred to it their rights under the contracts, and the corporation resold the automobiles for the amounts of the unpaid balances on the contracts and placed the proceeds of such resales in its general bank account, where they became commingled with other funds, and, within four months prior to the appointment of a receiver for the corporation, made payments by checks on its general bank account to the finance company for the balances due on such contracts;

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> since such payments enabled the finance company to obtain a greater proportion of its indebtedness against the corporation than other general creditors."

Appellee argues that the relinquishment of the right to rescind the sale because of the non-payment of the check was a present consideration for the payment received and in support cites *Illinois Parlor Frame Co. v. Goldman,* 257 Fed., 300 (appellee's br. p. 15). However, appellee overlooks the timing of the transaction in the Illinois *Parlor* case. In that case the relinquishment occurred *on the same day that the alleged preference was received,* which day was *within the four months'* period. The court stated:

> "That appellant did not expressly assert a right of rescision as immaterial; it relinquished that right in confirming the sale; it then gave up a property interest equal to the value of the goods then on hand. To that extent *the transfer was for a present consideration,* and not preferential." (Emphasis supplied.)

In the instant case, however, the relinquishment of any right to rescind, (if any such existed) occurred prior to the commencement of the preferential four months' period when appellee failed to act when the check was not promptly received, failed to act when the check was not paid and acquiesced in the default on these two alleged conditions by redepositing the check which under the doctrine of the above quoted *Frech* case confirmed title in Chemurgy and made Chemurgy *appellee's debtor.* No preferential transfer then took

place—the preferential transfer took place later on February 3rd, 1947 (within the four months' period) and therefore the doctrine of the *Illinois Parlor* case of a transfer for a *present consideration* is not relevant.

On Page 17 appellee attempts to rely upon an allegation of fraud in the transaction, but there is no basis whatsoever in the record for a claim of fraud and the court found none. As stated in the Agreed Statement (Tr. 13) Whitemore's testimony is that it was agreed that a check would be mailed *after* receipt of the warehouse receipt. That the check was not to be mailed until after the warehouse receipt was received is further evidenced by Exhibit A to the Agreed Statement (Tr. 16), being the letter transmitting the warehouse receipt in which Chemurgy was directed to mail a check to Benzel. The mere unexplained failure to immediately transmit a check, which could have been caused by many reasons, certainly raises no inference of fraud and of course the initial non-payment of the check does not indicate that title was obtained by fraud because the title, by agreement of the parties under the warehouse receipt statute (Rem. Rev. Stat. § 3627), vested by delivery of the warehouse receipt *prior to the issuance of the check.* Furthermore, the check when issued was not promptly deposited by Benzel who waited four days before even depositing the check for collection giving plenty of opportunity for the impact of other transactions upon the account of Chemurgy in the Wenatchee bank. This was not a case where an N.S.F. check was used to induce the transfer of possession and title.

Appellee finally contends (appellee's br. p. 21):

> "Benzel had the right upon dishonor of the check to retake the property or *to recover the proceeds* of the sale. *Benzel elected to recover the proceeds* of the sale rather than retake the property. The waiver of the right to Benzel to retake the property is a sufficient present consideration passing to the creditors for the recovery of the proceeds of the sale."

There is absolutely no basis in the record to support the statement that Benzel *elected to, or did,* recover the "proceeds of the sale." The wheat was delivered January 3rd, 1947. Chemurgy was in the business of manufacturing wheat into glucose and there is no evidence whatsoever as to what became of the wheat or that there were any "proceeds" out of the wheat which could have been recovered a month later (February 3, 1947) when Chemurgy's check was paid by its bank.

CONCLUSION

1. The main contention of defendant's brief is that title did not pass to the wheat until the check was paid. This premise is untenable for the following reasons:

a. Title passed when the negotiable warehouse receipt was delivered to Chemurgy (mailed January 3rd, 1947, received January 4th, 1947), Rem. Rev. Stat. § 3627 and § 5836-33, Finding II (Tr. 25), *Goodwin v. Bear,* 122 Wash. 49,209 P. 1080.

b. Even if the sale had been made on condition that a check would be mailed upon delivery of the warehouse receipt, this condition fell and title passed when Benzel

elected not to stand on the condition when it was not satisfied, but accepted a check ten days after delivering the wheat. This election to pass title is further emphasized by the fact that when the check was not paid defendant again did not insist on possession of the wheat but relied upon Chemurgy's promise to pay, thus demonstrating as a matter of law that title passed.

> "Reliance upon a subsequent promise to pay, that leads the seller to refrain from asserting his right to retake the property, is in itself a waiver of the right, and makes absolute a delivery which in the first instance was conditional. The right of plaintiff to recover back his property after he had delivered it resulted from the buyer's failure to keep his first promise. His failure to keep subsequent promises to pay could neither prolong nor revive that right." *Frech v. Lewis,* 218 Pa. 141, 67 Atl. 45.

2. Upon the passing of title on January 3, 1947, an obligation to pay for the wheat arose. Thus, when the check was paid out of the funds of Chemurgy within the four months' period Benzel was a creditor receiving payment upon an obligation arising prior to the four months' period and the Washington preference statute requires that the payment be returned.

> "But absent such a claim (of security), all inquiry regarding the status of a preference is limited to what took place within the four months' period * * * credits received by the insolvent from the creditor prior to the four months' period, unless enjoying statutory priority or secured in some manner, may not be setoff or taken into consideration in any other way, whether or not the insolvent

made a profit on the transaction." *Seattle Association of Credit Men v. Hudson,* 135 Wash. Dec. 643 at p. 647, 214 P.(2d) 681.

The fact that the obligation owing to Benzel arose within the month prior to the four months' period is of course no reason to distinguish this case from the many other cases in which the creditors have been required to return their payments. As a matter of fact, in other cases involved in this bankruptcy the obligations upon which payments were made and which were required to be returned by judgments entered, arose even subsequent to the Benzel obligation. It has been conclusively held that the fact that the creditor does not regard the transaction as an extension of credit is immaterial.

"That the parties did not regard nor intend the transaction as an extension of credit, makes the payment nonetheless a preference." *Seattle Association of Credit Men v. Daniels,* 15 Wn.(2d) 393 at p. 397, 130 P.(2d) 892.

The judgment of the District Court should be reversed with direction to enter judgment for the appellant as prayed for in the complaint.

Respectfully submitted,

EGGERMAN, ROSLING & WILLIAMS
DEWITT WILLIAMS
Attorneys for Appellant

No. 12735

United States
Court of Appeals
for the Ninth Circuit.

H. L. JONES,

Appellant,

vs.

BARTELDES SEED COMPANY, a Corporation,

Appellee.

Transcript of Record

**Appeal from the United States District Court,
Northern District of California,
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Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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Attorneys for defendant and appellant.

In the District Court of the United States in and for the Northern District of California, Northern Division

No. 6067

THE BARTELDES SEED COMPANY, a Corporation,

Plaintiff,

vs.

H. L. JONES, Individually and Doing Business Under the Style and Trade Name of STANDARD SEED FARMS COMPANY,

Defendant.

COMPLAINT

Plaintiff alleges:

I.

That the plaintiff is now and at all times hereinafter mentioned was a corporation duly organized and existing under and by virtue of the laws of the State of Colorado; that the defendant is an individual doing business under the style and trade name of Standard Seed Farms Company, with his residence and main business headquarters located at Stockton, California.

II.

That "Yellow Globe Danvers" is now and at all times hereinafter mentioned was a particular variety or type of onion, well known to, and catalogued, grown, cultivated, harvested, stored, bought and sold

by, the garden seed trade, industry and onion growers throughout the United States; "Yellow Globe Danvers" onion is uniformly and generally recognized by the seed trade, industry and onion growers and experts as a variety or special type of onion, possessing and generally known for certain qualities and characteristics and in particular, superior keeping and storing qualities. That it is impossible by examination, inspection or otherwise to recognize or identify the variety or type of any onion from the seed thereof. The variety and type can be determined only from the sets or mature onions after the seed is planted and grown. Accordingly, a buyer of onion seed must depend and rely upon the sellers' designation, description and representation of the variety or type of the onion seed sold.

III.

That on or about October 20, 1943, the defendant solicited and offered to sell plaintiff about two thousand (2000) pounds of "Yellow Globe Danvers" onion seed at the price of Two dollars and fifty cents ($2.50) per pound; that plaintiff accepted said offer and requested delivery thereof to it at Denver, Colorado; that on or about October 28, 1943, defendant delivered to plaintiff at Denver, Colorado, two thousand and five (2005) pounds of onion seed tagged, labeled, billed, described and otherwise represented as "Yellow Globe Danvers" onion seed; that relying upon said offer and said bill, description and representation by defendant that said onion seed was "Yellow Globe Danvers" onion seed, plaintiff

accepted such delivery and thereupon paid defendant Five Thousand Twenty-nine and 30/100 ($5,029.30) Dollars for said seed.

IV.

That plaintiff was unable to identify the variety or type of said onion seed by examination, or otherwise, and relying upon defendant's said designations and representations aforesaid and believing in good faith said onion seed to be "Yellow Globe Danvers" onion seed, plaintiff resold approximately two thousand (2000) pounds thereof, one thousand (1000) pounds thereof being resold and delivered to Dutch Valley Growers, Inc., an onion set cooperative growers' marketing association incorporated under the laws of the State of Illinois, on or about November 19, 1943, as "Yellow Globe Danvers" onion seed; that said Dutch Valley Growers, its members and customers, planted, or caused to be planted, cultivated and matured into sets said seed, after which it complained to plaintiff that said sets shrivelled, sprouted, decayed, kept poorly, and did not have the typical characteristics, shape or fine and desirable qualities of "Yellow Globe Danvers" onion, and in fact was not "Yellow Globe Danvers" onion or onion set. That plaintiff promptly advised defendant of said complaints and requested defendant to inspect said onion sets grown from seed so sold by defendant and verify said complaints, which defendant failed or refused to do; that thereafter said Dutch Valley Growers sued plaintiff in the United States District Court for the District of Colorado, being Civil Action No. 1405 demanding judgment for

Thirty-four Thousand Three Hundred Eighty-seven and 28/100 ($34,387.28) Dollars and costs, because of said defendant's false sale of said onion seed and the loss of crops therefrom; that plaintiff requested defendant to appear and defend said case, which defendant failed or refused to do; that plaintiff was required to and did defend said suit, which necessitated taking numerous depositions in California, Illinois, Washington, D. C., and elsewhere, consumed one week in court trial before court and jury and caused plaintiff to expend Seven Thousand Four Hundred Two and 59/100 ($7,402.59) Dollars for attorneys fees, court costs, traveling and other legal expenses, and plaintiff owes and has promised to pay an additional One Thousand Dollars ($1,000.00) attorneys' fees; that said litigation extended over a period of approximately three years; that the jury in said case brought in a verdict for said Dutch Valley Growers and against this plaintiff, sustaining the complaints and allegations of said Dutch Valley Growers and judgment was rendered against this plaintiff for Four Thousand Six Hundred Eighty-four and No/100 Dollars ($4,684.00) plus costs of Three Hundred Twenty-two and 26/100 Dollars ($322.26); that plaintiff gave defendant an opportunity to pay said judgment or appeal same, which defendant failed or refused to do; fearing that a new trial, if granted, or an appeal would result in a larger judgment against plaintiff, plaintiff paid said judgment and costs and now seeks to recover the amount thereof from defendant, plus interest from the date of payment.

V.

That plaintiff has paid Seven Thousand Four Hundred Two and 59/100 Dollars ($7,402.59) for attorneys' fees and legal expenses, and plaintiff owes and has promised to pay an additional One Thousand Dollars ($1,000.00) attorneys' fee in the defense of said Dutch Valley Growers case, which fee and expenses are reasonable and fair, and which plaintiff seeks to recover from defendant herein.

VI.

That defendant's said identification, labels, tags, bill and said other descriptions and representations made by defendant concerning said two thousand five (2005) pounds of onion seed were false and made in wanton or reckless disregard and violation of plaintiff's rights, feelings and reputation, and were calculated to and did specifically damage plaintiff aforesaid, and also caused plaintiff to suffer detriments incidental thereto, and to suffer substantial loss of good will and to sustain injury to its reputation with its customers and the seed trade and industry generally, in the sum of Ten Thousand Dollars ($10,000.00), which plaintiff seeks to recover from defendant.

VII.

That the United States of America by and through its United States Attorney for the Northern District of California, did on the 26th day of June, 1946, file an information against defendant herein, in Case No. 9701 in the District Court of the United States for the Northern District of California, charging

this defendant with falsely labelling and advertising, within the meaning of the Federal Seed Act of 1939, the two thousand five (2005) pounds of seed involved here, in that said seed was designated as "Yellow Globe Danvers" onion seed, whereas it was not "Yellow Globe Danvers" onion seed; that thereafter said court assessed a fine against defendant herein for such false labelling and advertising; that defendant did pay the fine so assessed.

VIII.

That, although plaintiff has demanded of defendant that he reimburse it for the payment of said judgment and costs in said Dutch Valley Growers case, pay the attorneys' fee and legal expenses incident to the defense thereof, pay it for the loss of good will, damage to its reputation and incidental detriments, defendant fails and refuses to do so.

IX.

That it is necessary for plaintiff to employ attorneys, pay court and service costs, deposition and traveling expenses and incur other expenses incident to the litigation, to protect its rights and enforce its claims against the defendant, the amount and extent of which cannot be ascertained now, but which is tentatively estimated to be about Seven Thousand Five Hundred Dollars ($7,500.00) which sum would be reasonable, and judgment for which is sought by plaintiff against defendant.

Wherefore, Plaintiff prays judgment against defendant in the sum of Thirty Thousand Nine Hun-

dred Eight & 85/100 Dollars ($30,908.85), together with legal interest thereon, for costs of suit herein expended, and for such other and further relief as to the court may seem meet and proper in the premises.

Dated: November 8th, 1948.

MULL & PIERCE,

/s/ F. R. PIERCE,

HUFFMAN, SUTLIFF AND ROGERS,

/s/ RANGER ROGERS,

Attorneys for Plaintiff.

[Endorsed]: Filed November 8, 1948.

At a stated term of the Northern Division of the United States District Court for the Northern District of California, held at the Court Room thereof, in the City of Sacramento, on Friday, the 31st day of December, in the year of our Lord one thousand nine hundred and forty-eight.

Present: The Honorable Dal M. Lemmon,
District Judge.

No. 6067

[Title of Cause.]

MINUTE ORDERS DEC. 31, 1948

The motion to dismiss, the motion to strike and the motion for a more definite statement having been

heretofore heard and submitted, being now fully considered, it is Ordered that the motion to dismiss be and the same is hereby denied. It is further Ordered that defendant's motion to strike be and the same is hereby denied as to paragraph VI, of the complaint, and granted as to paragraph VII and IX of the complaint. It is further Ordered that the defendants motion for a more definite statement be and the same is hereby denied. It is further Ordered that the defendants have 15 days from the date hereof within which to file their answer.

[Title of District Court and Cause.]

ANSWER

Comes now the defendant in the above-entitled action and for answer to the plaintiff's complaint herein admits, denies, avers and alleges as follows:

I.

Answering paragraph II of plaintiff's complaint on file herein defendant denies that the variety or type of onion known as "Yellow Globe Danvers" possesses and is generally known for superior keeping and storing qualities.

II.

Answering paragraph III of said complaint defendant denies that on or about October 20th, 1943, or at any other time, or at all, he solicited and offered to sell to plaintiff any quantity of "Yellow Globe Danver" onion seed at the price of Two and

50/100 ($2.50) Dollars per pound, or at any other price; alleges that prior to October 20th, 1943, defendant, as is the yearly custom of those engaged in the seed farm business, mailed to the plaintiffs and divers others in the seed business, a list containing the names of the seed that the defendant had in stock and the approximate price, which price would be subject to defendant's confirmation; that on or about October 20th, 1943, plaintiff offered to purchase from the defendant approximately two thousand (2,000) pounds of onion seed having the characteristics of "Yellow Globe Danvers" onion seed at the price of Two and 50/100 ($2.50) Dollars per pound, shipment to be made f.o.b. Stockton, California; that defendant accepted such offer and delivered to the Independent Freight Lines at Stockton, California, on or about the 20th day of October, 1943, twenty (20) bags of onion seed of the characteristics of "Yellow Globe Danvers" to be shipped f.o.b. Stockton, California, to the plaintiff in Denver, Colorado; that on the invoice covering said shipment there was printed a non-warranty notice substantially as follows:

> "Disclaimer—The Standard Seed Farms Co. gave no warranty express or implied as to description, purity, productiveness or any other matter of any seeds they send out and they will not be in any way responsible for the crop";

alleges that each and every bag or package containing said onion seeds in the aforementioned shipment contained a card or slip upon which was printed a non-warranty clause substantially as follows:

"The Standard Seed Farms gives no warranty express or implied, as to the description, quality, productiveness or any other matter, of seeds, bulbs or plants it sends out and that they will not in any way be responsible for the crop."

Further answering paragraph III of said complaint defendant alleges that the plaintiff prior to the commencement of this action had purchased the seeds from the defendant, and that in each instance when he so purchased seeds from the defendant there was boldly printed on each letter, and on each package of seed, the notice of non-warranty aforementioned; that the plaintiff itself in the seed business at the time it received the aforementioned shipment of seed, well knew and was fully advised of, and plaintiff itself used the non-warranty of description or quality or productiveness or failure of the crop, and hence knew that the contract was only for onion seed and the characteristics of the different types would not be warranted;

And further answering paragraph III of said complaint, defendant denies that at the time he accepted plaintiff's seed offer, or at the time of filling said order, or at the time of shipping said onion seed to the plaintiff, or at any other time, defendant did warrant and represent, or did warrant or represent to the plaintiff that the said onion seed so ordered from the defendant by the said plaintiff, and so shipped by said defendant to said plaintiff, was of the variety known as "Yellow Globe Danvers" seed.

III.

Answering paragraph IV of said complaint defendant denies that fully or otherwise, or at all, relying upon any representations or warranty of said defendant, said plaintiff re-sold approximately two thousand (2,000) pounds of said onion seed, and in particular one thousand (1,000) pounds to the Dutch Valley Growers, Inc.

Alleges that he has no information or belief as to the other matters set forth in paragraph IV of plaintiff's complaint sufficient to answer the same, and for that reason and placing his denial on that ground, denies generally and specifically, conjunctively and disjunctively, each, all and every allegation therein contained;

Further answering the allegations of paragraph IV of said complaint, defendant denies that by reason of the premises, or by reason of any fact or by reason of any act or omission of this defendant, or otherwise, or at all, the plaintiff herein was sued by the Dutch Valley Growers in the United States District Court for the District of Colorado, Civil Action No. 1405, or that plaintiff was compelled to and did expend the sums alleged and set forth in said paragraph IV for attorneys' fees, costs of suit and payment of judgment, or any sum whatsoever.

IV.

Alleges that he has no information or belief upon the subject matter of paragraph V of said complaint sufficient to enable him to answer the same, and placing his denial upon that ground denies that plaintiff has paid the sum of Seven Thousand Four

Hundred Two and 59/100 ($7,402.59) Dollars, or any other sum for attorneys' fees and legal expenses or that plaintiff owes and has promised to pay an additional One Thousand ($1,000) Dollars or any other sum, as attorneys' fees in the defense of said Dutch Valley Growers case, or that said fee and expenses, if any, are reasonable, and/or fair.

V.

Answering paragraph VI of said complaint, alleges that in compliance with plaintiff's offer, said defendant, in good faith and in the usual and ordinary course of business, attempted to fill the order of said plaintiff in compliance with its directions, and then and there shipped to said plaintiff at the time in said complaint mentioned, onion seed which the said defendant, then and there verily believed and then and there had reason to believe was in fact onion seed of the characteristics of "Yellow Globe Danvers," that in pursuance to and in compliance with the general established usage and custom of the seed business in the State of California, and the United States, and in compliance with and in conformity to his own usage and custom in that behalf, the said defendant enclosed with the bag or package containing said seed a slip on which was printed substantially as follows:

> "The Standard Seed Farms Co. gives no warranty, express or implied, as to description, quality, productiveness, or any other matter, of seeds, bulbs, plants or trees they send out, and they will not be responsible in any way for the crop."

Alleges that the plaintiff prior to the commencement of this action had, at various and sundry times, purchased seeds from defendant, and that in each instance when it so purchased from this defendant, each package of seeds delivered by defendant to plaintiff contained the said slip upon which was printed the said notice of non-warranty as aforesaid; that the plaintiff at the time of ordering said onion seed of the characteristics of "Yellow Globe Danvers," and at the time it received the same, well knew and was fully advised and had notice of the general established usage and custom of the seed trade in the State of California, and the United States herein mentioned; and of the established usage and custom of defendant; that this defendant in no instance sold any seed with any warranty, express or implied as to description, quality or productiveness or failure of the crop, and that with each package of seed sold or delivered by defendant that there was contained a printed slip giving notice that the said defendant gave no warranty express or implied as to the description, quality, productiveness or the failure of the crop, and that the defendant would not be responsible for any crop produced from the seeds shipped by him; that plaintiff being itself in the seed business knew full well of the usage and custom of the trade as to the non-warranty of the description, quality, productiveness or failure of the crop of the seed sold;

Further answering paragraph VI of said complaint, defendant denies that plaintiff has been damaged in the sum of Ten Thousand ($10,000)

Dollars, or in any other sum, or at all; denies that plaintiff has suffered loss of good will and/or injury to its reputation by reason of any act of said defendant.

For a Further and Separate Defense herein defendant alleges that his business has been established and conducted in the State of California for a period of about thirty-two (32) years, and at all times in said complaint mentioned, and for many years prior thereto, it has been and still is the general and well established custom and usage of the seed trade throughout the State of California, and the United States, among persons, firms and corporations engaged in the seed business, and among persons purchasing seeds, that the seller of seeds gives no warranty, express or implied, as to description, quality or productiveness of any seed sold, and that the seller will not be in any way responsible for the crop and that at all times in said complaint mentioned, and for many years prior thereto, it has been and still is the well established particular usage and custom of the said defendant in selling seeds that he gives no warranty, express or implied, as to description, quality, productiveness, or any other matter of seeds sent out and that he will not be responsible for the crop; and that the said plaintiff was at all times in said complaint mentioned, and for many years prior thereto had been, thoroughly familiar with and had full knowledge and notice of such general and well established custom and usage of the seed trade throughout the State of California and the United States, among persons, firms and corpo-

rations engaged in the seed business in the State of California and the United States, and of the said particular custom and usage of the defendant herein, and that the said plaintiff had at all times and on each and every occasion that it purchased any seeds from this defendant, and particularly on the occasions referred to in said complaint, such knowledge and notice and that the said plaintiff contracted in the purchase of said seeds from defendant with reference to the said well established custom and usage of the seed trade in the State of California and in the United States, and of the said particular custom and usage of this defendant, and that the same formed a part of the contract of purchase and sale of the seeds herein specifically mentioned.

And further alleges that said contract referred to in said complaint was for delivery of onion seed, and that said contract was fully performed by the delivery of said onion seed f.o.b. Stockton, California, and that defendant made no representation as to characteristics or descriptions of the seed delivered; and that as a result thereof there was no breach or representation or warranty.

Wherefore, defendant prays that plaintiff take nothing by reason of this action, and that defendant have judgment for his costs and disbursements herein, and for such other and further relief as to the Court may seem meet and proper.

/s/ JAMES I. HARKINS,
Attorney for defendant.

State of California,
County of San Joaquin—ss.

H. L. Jones being first duly sworn, deposes and says:

That he is the defendant named in the above-entitled action; that he has read the foregoing Answer and knows the contents thereof; that the same is true of his own knowledge, except as to those matters which are therein stated on information or belief, and as to those matters he believes it to be true.

/s/ H. L. JONES.

Subscribed and sworn to before me this 15th day of January, 1949.

[Seal] /s/ JAMES I. HARKINS,
Notary Public in and for the County of San Joaquin, State of California.

Affidavit of Service by Mail attached.

[Endorsed]: Filed January 21, 1949.

[Title of District Court and Cause.]

MEMORANDUM

The weight of authority is that the plea of nolo contendere is for all purposes considered a plea of guilty except in one situation, namely, that the defendant is not estopped from denying the facts to which he plead nolo contendere in a subsequent civil action. Cases cited and see Yale Law Review, Vol. 51 at page 1255.

Since defendant's counsel states in his closing brief that he is willing to admit that the plea of nolo contendere was entered for the limited purpose of impeachment no ruling is necessary at this time.

Dated: May 10th, 1949.

/s/ DAL M. LEMMON,
United States District Judge.

[Endorsed]: Filed May 10, 1949.

[Title of District Court and Cause.]

PRE-TRIAL ORDER

This cause came on regularly for pre-trial before the Honorable Dal M. Lemmon, District Judge, on March 21, 1949. Plaintiff was represented by Ranger Rogers, Esq., and A. M. Mull, Jr., Esq., and the defendant was represented by James I. Harkins, Esq., and Albert Cronin, Esq.

State of Nature of Case:

Action for breach of contract for damages sustained because of failure to deliver variety of onion seed ordered. Plaintiff, The Barteldes Seed Company, is a Colorado corporation, and defendant is H. L. Jones, of Stockton, California, an individual doing business as Standard Seed Farms Company.

Defendant reserves the right to contend that the action is one for breach of warranty.

The elements of damage claimed by plaintiff are three: (1) reimbursement of plaintiff for the amount of judgment and costs paid by plaintiff as

the result of an action for breach of contract brought against plaintiff in the United States District Court for the District of Colorado by the purchaser from the plaintiff of a portion of the seeds involved in this action; (2) attorneys fees and expenses necessitated in the defense of said action; and (3) loss of good will and related matters suffered because of resale of seeds involved in this action.

Admissions and Identification of Exhibits:

Plaintiff offered in evidence a certified copy of complaint, verdict, judgment, and satisfaction of judgment docket in the matter of Dutch Valley Growers, Inc., vs. The Barteldes Seed Company, Civil Action No. 1405 in the United States District Court for the District of Colorado. These documents were marked Plaintiff's Exhibit No. 1 and admitted in evidence.

Plaintiff then offered in evidence certified copy of transcript of the judgment docket in the above referred to case. This was marked as Plaintiff's Exhibit No. 2 and admitted in evidence.

Plaintiff then offered in evidence a statement of attorneys fees and costs paid by the defendant, The Barteldes Seed Company, in the litigation above referred to in the United States District Court in Colorado. The defendant admitted that these were paid by The Barteldes Seed Company, but denied that they were or are reasonable or necessary expenditures in the defense of the said Civil Action No. 1405. With this understanding the statement was identified as Plaintiff's Exhibit No. 3 and admitted in evidence.

Plaintiff then offered in evidence Customer's Draft dated October 20, 1943, which was marked Plaintiff's Exhibit No. 4 and admitted in evidence. It was stipulated that said draft was paid by plaintiff herein.

On agreement of counsel, a telegram dated October 20, 1943, from The Barteldes Seed Company to Standard Seed Farms Company, Stockton, California, was marked as Plaintiff's Exhibit No. 5 for identification, and it was agreed that the said exhibit could be offered in evidence without further proof by either party, and that it could be received in evidence without further identification if otherwise admissible.

A letter dated October 21, 1943, from The Barteldes Seed Company to Standard Seed Farms Company, was marked as Plaintiff's Exhibit No. 6 for identification, and it was agreed in regard to this exhibit that it could be offered in evidence without further identification at the time of the trial by either party.

It was next stipulated and agreed that certain onion sets identified by the United States Department of Agriculture, War Food Administration, Division of Distribution, Inspection Certificates Numbered B-55718, B-55719 and B-55720 were taken from warehouses near South Holland, Illinois, used by the growers of said onion sets, by an agent or inspector of the Department of Agriculture and were by him forwarded, through official channels, to Dr. H. A. Jones of the Department of Agriculture, whose address is Beltsville, Maryland.

It was stipulated and agreed that said onion sets identified by Inspection Certificate No. B-55718 were grown by C. W. Pearlberg at or near South Holland, Illinois, during the season of 1944; that said onion sets identified by Inspection Certificate No. B-55719 were grown by A. Dalanberg at or near South Holland, Illinois, during the season of 1944; and that said onion sets identified by Inspection Certificate No. B-55720 were grown by John K. DeYoung at or near South Holland, Illinois, during the season of 1944.

Defendant then offered in evidence Defendant's Exhibit A a memorandum that a bill of lading had been issued. It was stipulated and agreed that Defendant's Exhibit A, although not the original bill of lading, could be admitted in evidence and for the purposes of the case treated as though it were the original.

The court then asked for memoranda in regard to the admissibility of a plea of nolo contendere in evidence. At the time of the signing of this order these have been duly submitted.

Dated the 16th day of May, 1949.

/s/ DAL M. LEMMON,
Judge.

Approved as to form:

/s/ RANGER ROGERS,
Attorney for Plaintiff.

/s/ JAMES I. HARKINS,
Attorney for Defendant.

[Endorsed]: Filed May 16, 1949.

[Title of District Court and Cause.]

MEMORANDUM AND ORDER

Plaintiff purchased onion seed from the defendant and later sold a portion of it. The buyer of this portion sued plaintiff on the theory that the onion seed was not of the variety specified. Judgment was recovered in the United States District Court for the District of Colorado in favor of the buyer and against plaintiff. The judgment was satisfied in full by plaintiff. Plaintiff seeks to recover from defendant the amount of said judgment, costs and attorneys' fees expended in that action, and damages for loss of good will arising out of that transaction. The complaint also sought the estimated attorneys' fees incurred and to be incurred in the present case, but the paragraph therein alleging the same has been disposed of by the granting of a motion to dismiss thereto.

Defendant in the course of his business as a seed grower and seller sent a "surplus list," a statement of quantities and varieties of seed for sale, to the plaintiff, in which was listed a quantity of "Yellow Globe Danvers" onion seed. Plaintiff by telephone from its office in Denver, Colorado, to defendant in California offered to buy 2000 pounds of said seed at $2.50 per pound. After some discussion of price this order was accepted by the defendant; it being agreed that the seed would be shipped by truck f.o.b. Stockton, California. No mention was made in that conversation of warranty or refusal to warrant. A telegram confirming the order was sent by plaintiff

and each party sent letters confirming the sale. Printed on defendant's letterheads were non-warranty clauses, and the "surplus list" also set forth such a clause. The seed was shipped and a draft with bill of lading was sent. The draft was honored by plaintiff.

Thereafter the seed was re-labeled by plaintiff and a portion of it sold with the resultant suit in Colorado.

It is contended by plaintiff that the sale was completed in Colorado, inasmuch as it was necessary that the draft be honored before plaintiff could take possession of the seed. On the other hand defendant contends that the transaction was completed when the seed was delivered to the carrier at Stockton, California. Plaintiff therefore argues that the law of Colorado is the applicable law, while defendant argues that California law should be applied.

It seems to me that a consideration of the basic elements in the creation of a contract dispels most of the questions that appear to complicate this case.

The evidence is clear that plaintiff ordered a quantity of "Yellow Globe Danvers" onion seed by that name and that this designates a variety of onion seed that is distinctive and well known in the trade. Plaintiff's offer was accepted by defendant. It is elementary that where an offer to buy certain goods at a certain price is accepted by the seller a contract is made. Where such a contract is made orally and later confirmed in writing the contract can not be varied by additional terms or conditions, unless the parties mutually

intend to alter the original agreement. Therefore the mere fact that the oral agreement was confirmed by a writing upon which a printed non-warranty clause appeared as part of the letterhead is not sufficient to incorporate said clause as one of the contractual terms. A disclaimer of warranty coming after the contract was completed is of no effect. Newhall Land & Farming Co. v. Hogue Kellogg Co., 56 Cal. App. 90.

Plaintiff therefore had offered to buy a specific commodity and defendant had agreed to sell a specific commodity. The fact that the defendant did not perform resulted in a breach of contract. The question of warranty in such a case would appear to be academic since the designation of the specific type of seed appears more in the nature of a condition. The agreement to sell "Yellow Globe Danvers" onion seed was an express warranty, if not a condition, that the seed shipped was of that variety. Uniform Sales Act, Sec. 12. This was an affirmation of fact by express language, relied upon by plaintiff and without which the purchase would not have been made. Nevertheless, because the Uniform Sales Act, which has been adopted by both California and Colorado, fixes an implied warranty that the goods shall correspond to the description in a contract to sell or a sale of goods by description, it is difficult to ignore the question of warranty whenever such a sale is made. "Yellow Globe Danvers" is an article of commerce. It is a distinctive seed, well known in the trade. A dealer in such a commodity selling it under or by that name is charged with notice

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that the buyer relies upon the description as a representation that it is the thing described. This constitutes a warranty that the seed sold is of that description. Smith v. Zimbalist, 2 Cal. App. 2d 324. Thus, in this case, since there was a contract to sell and consequent sale of goods by description, a warranty that the goods were of the class denominated was created by operation of law as well as in fact. (El Zarape, etc., Factory v. Plant Food Corp., 90 Cal. App. 2d 336, 345. See also Chamberlain Co. v. Allis Chalmers Co., 51 Cal. App. 2d 520).

Plaintiff has sustained its burden of proof. The creation of an express warranty herein has evidentiary support in the deposition of W. P. Stubbs, Manager of the Denver Branch of plaintiff company and the testimony of defendant pertaining thereto. Neither mentioned the word "warranty" in the telephonic conversation which created the contract. The deposition of Stubbs regarding that conversation reads in part as follows: "I told him that we had his surplus list, and we would purchase the 2,000 pounds of Yellow Globe Danvers onion seed at $2.50, which he quoted in the list as $3.00 per pound. He accepted the order for the 2,000 pounds of Yellow Globe Danvers onion seed and stated that he would ship the same promptly. We purchased several other items from him at the same time, and I talked to him concerning those. I told him at the time that we only wanted first class quality stocks of high germination and true to type, and he assured me that the stocks were of first class quality and of high germination." Defendant stated in his oral testimony, "I do not

recall any of that conversation. As I remember I would say probably 95% of it was devoted to jockeying between the price of $3.00 and $2.00 a pound." Page 24-25 of transcript. Mr. Stubbs' statement that plaintiff wanted only seed of first class quality and true to type and the apparent assurance by defendant that the seed was of the type ordered is not denied and I find that an express warranty was made that the onion seed would be of the variety ordered, and the warranty was not dispelled by the printed non-warranty clauses which appeared on the letterheads and surplus list.

It was contended by the defendants that the warranty was nullified by the existence of a custom that seed growers and distributors of seed did not warrant as to description, productivity, etc. But the evidence presented supported the contention only insofar as productivity was concerned and did not support the contention that there was a custom that variety was not warranted, and in fact one of defendant's experts testified that variety was a factor that could be controlled and known.[1] Therefore the rationalle which would be the basis of the custom was lacking.

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[1]On cross-examination defendant's witness, James William Hamilton, was asked the following question and gave the following answer relevant to a non-warranty clause, "Only one question, Mr. Hamilton: I understand that the clause was used to protect the seedsmen from erratic growth in production. By that you don't mean variety of seed? A. That would not be variety. That would be a condition that we could not control. Variety is something that is established." Page 57, Transcript.

It must be remembered that defendant was the grower of the seeds in question and in a position to be certain of the variety. A greater burden should be placed upon the grower who is also the seller of the seed. See 168 A.L.R. at page 586.

There was a breach of contract by defendant and he is liable for the damages as a result thereof. A warranty promises indemnity against defects in the article sold. Regarding damages sought by plaintiff for loss of good will and business, the evidence introduced to support this claim for damages was insufficient to justify the granting of damages for this alleged loss to plaintiff. That claim is too speculative to be a foreseeable consequence of defendant's breach of warranty. Remote or speculative damages not reasonably within the contemplation of the parties are not recoverable. Calif. Press Mfg. Co. v. Stafford Packing Co., 192 Cal. 479. Furthermore, to be recoverable damages for breach of warranty must be certain or capable of being ascertained with a reasonable degree of certainty and not, as here, uncertain in amount.

The Uniform Sales Act, which has been incorporated into the statutes of both California and Colorado, provides that for a breach of warranty, the measure of damages shall be "* * * the loss attributable directly and naturally resulting in the ordinary course of events from the breach." 1 U.L.A. 69(6). The Act further provides that nothing therein affects the right of the buyer to recover special damages in any case where, by law, such are recoverable. U.S.A. 70.

Plaintiff and defendant had had prior business

dealings and defendant knew that plaintiff was in the seed merchandising business and consequently that there was every likelihood that the onion seed sold plaintiff would be resold by it. The seller's knowledge that the buyer is a dealer in the kind of goods purchased is sufficient to impute knowledge to the seller that the goods are purchased for resale. Northwest Auto Co. v. Harmon, 250 F. 832; Johnson v. Hislop, 272 Fed. 913, 9th Cir. When plaintiff resold some of the onion seed the act was foreseeable as a natural consequence of the contract between plaintiff and defendant. If the seller has notice from any source that the purchaser purchases for resale, the right to recover special damages which result from buyer's inability to reason of the seller's breach of the principal sale contract to perform arises since the resale may fairly be said to be within the contemplation of the parties at the time of the making of the principal contract. Calif. Press Mfg. Co. v. Stafford Packing Co., 192 Cal. 479. In such cases where a similar warranty is given on resale as was contained in the original agreement and the original purchaser is successfully sued for breach of warranty, the original seller is liable for the damages thus liquidated to his purchaser, and this includes attorney's fees necessitated in defense of the suit for breach of warranty, especially where the original seller was notified by the buyer to assist in the defense of the action. Robert A. Reichard, Inc., v. Ezl. Dunwoody Co., 45 F. Supp. 154. (See also Grupe v. Glick, 26 Cal. 2d 680. Int. State Bank

of Trinidad v. Trinidad Bean & Elevator Co., 79 Colo. 286, 245 Pac. 489, 25 C.J.S. Sec. 50c). And see 46 Am. Jur. 820. The rule is applied where seed is purchased by a dealer with warranty as to kind and resold by him with a like warranty. Buckbee v. P. Hohenodel, Jr., 224 Fed 14; Passinger v. Thornburn, 34 N.Y. 634. The facts of this case justify the application of this rule.

It is therefore ordered that judgment be entered in favor of plaintiff in the sum of $5006.26, the sum paid by plaintiffs as a result of the judgment against it in the United States District Court, District of Colorado, with interest from the date of judgment, $8,402.59 attorneys' fees incurred therein, plus interest from the date of payment, and for costs herein.

Plaintiff to prepare findings of fact in accordance with the local rule.

Dated: May 10th, 1950.

/s/ DAL M. LEMMON,
United States District Judge.

[Endorsed]: Filed May 10, 1950.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled action came on regularly for trial before the above-entitled court, without a jury,

a jury having been waived, on the 22nd day of September, 1949, having been duly and regularly continued until that date, plaintiff appearing by its attorneys, Huffman, Sutliff & Rogers, and Mull & Pierce, and the defendant appearing by his attorney, James I. Harkins, Esq., and evidence both oral and documentary having been introduced and the cause argued and submitted for the decision of the court and the court being fully advised, now makes and files his findings of fact and conclusions of law, to wit:

Findings of Fact

I.

That it is true that the plaintiff is now and at all times hereinafter mentioned was a corporation duly organized and existing under and by virtue of the laws of the State of Colorado; that the defendant is an individual doing business under the style and trade name of Standard Seed Farms Company, with his residence and main business headquarters located at Stockton, California.

II.

That it is true that "Yellow Globe Danvers" is now and at all times hereinafter mentioned was a particular variety or type of onion, well known to, and catalogued, grown, cultivated, harvested, stored, bought and sold by, the garden seed trade, industry and onion growers throughout the United States; "Yellow Globe Danvers" onion is uniformly and generally recognized by the seed trade, industry and onion growers and experts as a variety or special type of onion, possessing and generally

known for certain qualities and characteristics. That it is impossible by examination, inspection or otherwise to recognize or identify the variety or type of any onion from the seed thereof. The variety and type can be determined only from the sets of mature onions after the seed is planted and grown. Accordingly, a buyer of onion seed must depend and rely upon the sellers' designation, description and representation of the variety or type of the onion seed sold.

III.

That it is true that some time prior to October 20, 1943, defendant by a statement in writing solicited plaintiff to purchase of and from defendant various quantities and varieties of onion seed, including a quantity of a variety known as "Yellow Globe Danvers." That thereafter and on or about the 20th day of October, 1943, plaintiff offered to purchase a specific quantity of "Yellow Globe Danvers" onion seed, to wit: approximately 2,000 pounds, at and for the purchase price of Two and 50/100th Dollars ($2.50) per pound; provided, however, that said plaintiff stipulated as a condition to said purchase that said plaintiff would accept only first class quality stocks of high germination and true to type; that on or about said date defendant accepted said offer and agreed to sell to plaintiff said quantity of onion seed of said variety known as "Yellow Globe Danvers" at and for said purchase price F.O.B. Stockton, California, and to deliver the same to Denver, Colorado; that said agreement was confirmed in writing; that as a part of said agreement defendant expressly warranted,

represented and agreed that said onion seed and all of it was in fact "Yellow Globe Danvers"; that on or about October 28, 1943, defendant delivered to plaintiff at Denver, Colorado, Two Thousand and Five (2005) pounds of onion seed tagged, labeled, billed, described and otherwise represented as "Yellow Globe Danvers" onion seed; that said onion seed was delivered by defendant with sight draft attached to the bill of lading; that relying upon said offer and said bill, description, warranty and representation by defendant that said onion seed was "Yellow Globe Danvers" onion seed, plaintiff accepted such delivery and thereupon honored said draft at the First National Bank at Denver, Colorado, and paid defendant Five Thousand Twenty-nine and 30/100ths Dollars ($5,029.30) for said seed.

IV.

That it is true that plaintiff was unable to identify the variety or type of said onion seed by examination, or otherwise, and relying upon defendant's said warranty, designations and representations aforesaid and believing in good faith said onion seed to be "Yellow Globe Danvers" onion seed, plaintiff resold approximately two thousand (2000) pounds thereof, one thousand (1000) pounds thereof being resold and delivered to Dutch Valley Growers, Inc., an onion set cooperative growers' marketing association incorporated under the laws of the State of Illinois, on or about November 19, 1943, as "Yellow Globe Danvers" onion seed; that said Dutch Valley Growers, its members and cus-

tomers, planted, or caused to be planted, cultivated and matured into sets said seed, after which it complained to plaintiff that said sets shrivelled, sprouted, decayed, kept poorly and did not have the typical characteristics, shape or fine and desirable qualities of "Yellow Globe Danvers" onion, and in fact was not "Yellow Globe Danvers" onion or onion set. That plaintiff promptly advised defendant of said complaints and requested defendant to inspect said onion sets grown from seed so sold by defendant and verify said complaints, which defendant failed or refused to do; that thereafter said Dutch Valley Growers sued plaintiff in the United States District Court for the District of Colorado, being Civil Action No. 1405 demanding judgment for Thirty-four Thousand Three Hundred Eighty-seven and 28/100ths Dollars ($34,387.28) and costs, because of said defendant's false sale of said onion seed and the loss of crops therefrom; that plaintiff requested defendant to appear and defend said case, which defendant failed or refused to do; that plaintiff was required to and did defend said suit, which necessitated taking numerous depositions in California, Illinois, Washington, D. C., and elsewhere, consumed one week in court trial before court and jury and caused plaintiff to expend Seven Thousand Four Hundred Two and 59/100ths Dollars ($7,402.59) for attorneys' fees, court costs, traveling and other legal expenses, and plaintiff owes and has promised to pay an additional One Thousand Dollars ($1,000.00) attorneys' fees; that said litigation extended over a period of approximately three years; that the jury

in said case brought in a verdict for said Dutch Valley Growers and against this plaintiff, sustaining the complaints and allegations of said Dutch Valley Growers and judgment was rendered against this plaintiff for Four Thousand Six Hundred Eighty-four and No/100ths Dollars ($4,684.00) plus costs of Three Hundred Twenty-two and 26/100ths Dollars ($322.26); that plaintiff gave defendant an opportunity to pay said judgment or appeal same, which defendant failed or refused to do; fearing that a new trial, if granted, or an appeal would result in a larger judgment against plaintiff, plaintiff paid said judgment and costs. That at all times herein and in said complaint mentioned plaintiff was in the seed merchandising business and defendant knew that to be the fact; that the onion seeds purchased by plaintiff from defendant were purchased for resale to farmers for use in growing a crop of onions and onion sets and at all times herein and in said complaint mentioned defendant knew that to be the fact; that said onion seed when resold as hereinabove set forth were sold with the warranty description and representations regarding said onion seed which had been made by defendant to plaintiff repeated by plaintiff to said purchasers from plaintiff, and at all times herein and in said complaint mentioned defendant knew that such warranty, description and representation would be so made by plaintiff.

V.

That it is true that plaintiff has paid Seven Thousand Four Hundred Two and 59/100ths Dollars ($7,402.59) for attorneys' fees and legal ex-

penses, and plaintiff owes and has promised to pay an additional One Thousand Dollars ($1,000.00) attorneys' fee in the defense of said Dutch Valley Growers case, which fee and expenses are and each of them is reasonable and fair.

VI.

That it is not true that the representations, description and warranty, or any of them, made by defendant as aforesaid were wanton or reckless, or that they were calculated to or did cause plaintiff to suffer a substantial loss of good will or to sustain injury to its reputation with its customers, or the seed trade, or industry generally, in the sum of Ten Thousand Dollars ($10,000.00) or any other sum; but it is true that the representations, description and warranty were untrue in this that said onion seed and each and all of it sold and purchased as aforesaid was not "Yellow Globe Danvers" but was another inferior variety and it is also true that plaintiff has been damaged in the respects as hereinabove and hereinafter set forth in these findings.

VII.

That it is true that the United States of America by and through its United States Attorney for the Northern District of California, did on the 26th day of June, 1946, file an information against defendant herein, in Case No. 9701 in the District Court of the United States for the Northern District of California, charging this defendant with falsely labelling and advertising, within the mean-

ing of the Federal Seed Act of 1939, the two thousand five (2005) pounds of seed involved herein, in that said seed was designated as "Yellow Globe Danvers" onion seed; that thereafter said court assessed a fine against defendant herein for such false labelling and advertising that defendant did pay the fine so assessed.

VIII.

That it is true that although plaintiff has demanded of defendant that he reimburse it for the payment of said judgment and costs in said Dutch Valley Growers case, pay the attorneys' fee and legal expenses incident to the defense thereof, pay it for the loss of good will, damage to its reputation and incidental detriments, defendant fails and refuses to do so.

IX.

That it is not true that at all times in said complaint mentioned or at any of the times therein mentioned there was a custom or usage of the seed trade in the State of California or throughout the United States or elsewhere or at all or among persons purchasing seed or of defendant in selling seed, that the seller of seeds gives no warranty as to variety and/or description, but it is true that at all times in said complaint mentioned variety and description of onion seed can be controlled and is known by growers and sellers of seed generally and there is no custom or usage of the seed trade or of defendant disclaiming warranty of variety or description.

As Conclusions of Law from the Foregoing Facts the Court Finds:

That plaintiff is entitled to judgment:

(1) For the sum of Five Thousand Six and 26/100th Dollars ($5,006.26) being the amount of the judgment paid in said action in the United States District Court for the District of Colorado, together with interest at the rate of seven per cent (7%) per annum from the 15th day of June, 1948 (being the date of said judgment), in the sum of Six Hundred Eighty-seven and 16/100ths Dollars ($687.16).

(2) For the further sum of Seven Thousand Four Hundred Two and 59/100ths Dollars ($7,402.59) being the fair and reasonable attorneys' fees and expenses heretofore paid by plaintiff in said action in the United States District Court, District of Colorado, with interest on the following portions thereof at the rate of seven per cent (7%) per annum from the following dates and in the amounts respectively:

Principal Amount Paid	Date Paid	Interest to June 1, 1950 @ 7%
$ 250.00	5-21-45	$ 87.95
750.00	1- 3-46	231.72
600.00	5- 6-46	172.25
1,000.00	10-25-47	181.95
1,000.00	11-24-48	106.31
500.00	3-24-48	76.54
500.00	4-16-48	74.42
1,250.00	6- 5-48	174.01
1,552.59	6- 2-48	217.10
	Total Interest	$1,322.25

(3) For the further sum of One Thousand Dollars ($1,000.00) being the fair and reasonable attorneys' fees which are unpaid but which plaintiff is obligated to pay in said action in the United States District Court, District of Colorado; without interest.

(4) For plaintiff's costs of suit incurred herein. Let judgment be entered accordingly.

Dated: June 14th, 1950.

/s/ DAL M. LEMMON,
Judge of the United States
District Court.

Affidavit of Service by Mail attached.

Lodged May 24, 1950.

[Endorsed]: Filed June 14, 1950.

In the District Court of the United States, in and for the Northern District of California, Northern Division

No. 6067

THE BARTELDES SEED COMPANY, a Corporation,

Plaintiff,

vs.

H. L. JONES, Individually and Doing Business Under the Style and Trade Name of STANDARD SEED FARMS COMPANY,

Defendant.

JUDGMENT

The above-entitled action came on regularly for trial before the above-entitled court, without a jury, a jury having been waived, on the 22nd day of September, 1949, having been duly and regularly continued until that date, plaintiff appearing by its attorneys, Huffman, Sutliff & Rogers, and Mull & Pierce, and the defendant appearing by his attorney, James I. Harkins, Esq., and evidence both oral and documentary having been introduced and the cause argued and submitted for the decision of the court, and the court having heretofore made and filed its findings of fact and conclusions of law, and good cause appearing therefore;

It Is Hereby Ordered, Adjudged and Decreed:

(1) That the plaintiff do have and recover judgment from the defendant in the sum of Five Thousand Six and 26/100ths Dollars ($5,006.26) together

with interest at the rate of Seven per cent (7%) per annum from the 15th day of June, 1948, in the sum of Six Hundred Eighty-seven and 16/100ths Dollars ($687.16) or a total of principal and interest in the sum of Five Thousand Six Hundred Ninety-three and 42/100ths Dollars ($5,693.42).

(2) That the plaintiff do have and recover judgment from the defendant in the further sum of Seven Thousand Four Hundred Two and 59/100ths Dollars ($7,402.59) with interest on the following portions thereof at the rate of Seven per cent (7%) per annum from the following dates and in the amounts respectively:

Principal Amount Paid	Date Paid	Interest to June 1, 1950 @ 7%
$ 250.00	5-21-45	$ 87.95
750.00	1- 3-46	231.72
600.00	5- 6-46	172.25
1,000.00	10-25-47	181.95
1,000.00	11-24-48	106.31
500.00	3-24-48	76.54
500.00	4-16-48	74.42
1,250.00	6- 5-48	174.01
1,552.59	6- 2-48	217.10
	Total Interest	$1,322.25

or a total of principle and interest in the sum of Eight Thousand Seven Hundred Twenty-four and 84/100ths Dollars ($8,724.84);

(3) That the plaintiff do have and recover judgment from the defendant in the further sum of One Thousand Dollars ($1,000.00) without interest.

(4) That the plaintiff do have and recover judgment from the defendant for its costs of suit incurred herein hereby taxed in the sum of One Hun-

dred Ninety-three and 70/100ths Dollars ($193.70).

Dated: June 14, 1950.

/s/ DAL M. LEMMON,
Judge, United States District Court.

Lodged May 26, 1950.

[Endorsed]: Filed June 14, 1950.

[Title of District Court and Cause.]

NOTICE OF ENTRY OF JUDGMENT

To Defendant Above Named and to James I. Harkins, Esq., His Attorney:

You and Each of You Will Please Take Notice that judgment in the above-entitled action in favor of plaintiff and against defendant in the sum of Fifteen Thousand Four Hundred Eighteen and 26/100ths Dollars ($15,418.26) together with costs of suit herein was entered Wednesday, June 14, 1950.

Dated: June 21, 1950.

MULL & PIERCE,
By /s/ F. R. PIERCE,
HUFFMAN, ROGERS, & SUTLIFF,
/s/ KENAZ HUFFMAN, Esq.,
By /s/ F. R. PIERCE,
Attorneys for Plaintiff.

Affidavit of Service by Mail attached.

[Endorsed]: Filed June 22, 1950.

[Title of District Court and Cause.]

MOTION TO AMEND FINDINGS AND FOR ADDITIONAL FINDINGS TO BE MADE

Now comes the defendant and through his attorneys of record moves this Honorable Court to amend the findings and for additional findings to be made in the above-entitled cause:

1. The finding of fact as set forth in paragraph III in the above-entitled action, be amended to show that the quantity of onion seed purchased was to be delivered f.o.b. Stockton, California, and also to show the fact that there was no relationship between the purchase price and f.o.b. shipment of the goods.

2. Referring to Paragraph III, it is hereby requested that the additional findings of fact be made that a non-warranty clause containing the following words:

> "Standard Seed Farms Company Gives No Warranty, Express or Implied as to Description, Purity, Productiveness or Any Other Matter of Any Seeds They Send Out and They Will Not in Any Way Be Responsible for Any Crop,"

was plaintly printed at the top of the surplus list.

3. Referring to paragraph III, it is requested that the additional findings of fact be made that the manner of payment being made by sight draft

with bill of lading attached was done for the sole reason of security for purchase price.

4. Referring to paragraph VII, it is hereby requested that all matters of findings and fact set forth therein be stricken from the record.

5. It is hereby requested that a new and additional findings of fact be set forth stating that the contract was made in Stockton, California, and was performed in Stockton, California.

Wherefore, Defendant prays that the Court will amend the findings of fact and that additional findings of fact be made.

/s/ JAMES I. HARKINS,

/s/ ALBERT E. CRONIN, JR.,
Attorneys for Defendant.

Points and Authorities

Rules 52 and 52 (A) Federal Rules of Civil Procedure.

[Endorsed]: Filed June 26, 1950.

[Title of District Court and Cause.]

MOTION FOR NEW TRIAL

Now comes the defendant and through his attorneys of record moves this Honorable Court for a new trial in the above-entitled cause, and for reasons states as follows:

1. The judgment was contrary to law.

2. The judgment was contrary to the evidence.

3. The judgment was contrary to the weight of the evidence.

4. For such other and further reasons as may be presented at the hearing of this motion.

Wherefore, defendant prays that the Court grant a new trial.

/s/ JAMES I. HARKINS,

/s/ ALBERT E. CRONIN, JR.,
Attorneys for Defendant.

Points and Authorities

Rule 59 of the Federal Rule of Civil Procedure.

[Endorsed]: Filed June 26, 1950.

[Title of District Court and Cause.]

ORDER

Defendant's motion to amend findings is granted as to specification number IV and finding VII is stricken. Defendant's motion to amend findings in all other respects is denied.

Defendant's motion for a new trial is denied.

Dated: July 24, 1950.

/s/ DAL M. LEMMON,
United States District Judge.

[Endorsed]: Filed July 24, 1950.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given this 15th day of August, 1950, that H. L. Jones, said defendant, hereby appeals to the United States Circuit Court of Appeals for the Ninth Circuit from the judgment of this Court entered on the 14th day of June, 1950, in favor of plaintiff against said defendant.

/s/ JAMES I. HARKINS,

/s/ ALBERT E. CRONIN, JR.,
Attorneys for Defendant,
H. L. Jones, etc.

[Endorsed]: Filed August 21, 1950.

In the District Court of the United States for the Northern District of California, Northern Division

No. 6067

BARTELDES SEED COMPANY, a Corporation,
Plaintiff,

vs.

H. L. JONES, Individually and Doing Business Under the Firm Name and Style of STANDARD SEED FARMS COMPANY,

Defendant.

Before: Hon. Dal M. Lemmon,
Judge.

REPORTER'S TRANSCRIPT

Thursday, September 22, 1949

Appearances:

For the Plaintiff:

RANGER ROGERS, Esq., and

FRED R. PIERCE, Esq.

For the Defendant:

JAMES I. HARKINS, Esq., and

ALBERT E. CRONIN, JR., Esq.

(The deposition of W. P. Stubbs was read, Mr. Pierce reading the questions and Mr. Rogers reading the answers, as follows:)

DEPOSITION OF W. P. STUBBS

"Q. State your name and residence address.

"A. W. P. Stubbs, 1580 St. Paul Street, Apartment 1, Denver, Colorado.

"Q. What is your business address?

"A. Barteldes Seed Company, 1521 - 15th Street, Denver, Colorado.

"Q. What is your position?

"A. Manager of Barteldes Seed Company, Denver branch.

"Q. How long have you held that position?

"A. It will be 25 years in September.

"Q. How long have you been associated with the Barteldes Seed Company of Denver, Colorado?

"A. About 25 years.

(Deposition of W. P. Stubbs.)

"Q. Generally, what are your duties?

"A. To buy and sell seeds and merchandise pertaining to the seed business and other duties that a manager performs.

"Q. Is one of your duties to manage the garden seed business of The Barteldes Seed Company in Denver, Colorado? A. Yes.

"Q. What does this entail?

"A. Buying and selling of seeds and other merchandise, and supervising of the general business.

"Q. Do you buy and sell garden seeds?

"A. Yes.

"Q. For how many years have you been occupied with such functions?

"A. About twenty-five years.

"Q. Do you recall the purchase of about 2,000 pounds of Yellow Globe Danvers onion seed from Standard Seed Farms Company of Stockton, California, in late October of 1943? A. Yes.

"Q. How did this transaction come about?

"A. We received a surplus list from the Standard Seed Farms Company of Stockton, California, and among the different seeds they offered was 2,000 pounds of Yellow Globe Danvers onion seed, and I called Mr. H. L. Jones, the manager of Standard Seed Farms Company, over the telephone, and purchased from him 2,000 pounds of Yellow Globe Danvers onion seed at $2.50 per pound.

"Q. Did you receive a price list? A. Yes.

"Q. Describe this price list.

(Deposition of W. P. Stubbs.)

"A. Well, it quoted numerous items which they offered, subject to being unsold, which included 2,000 pounds of Yellow Globe Danvers onion seed.

"Q. Was it a surplus list? A. Yes.

"Q. Do you have it with you? A. Yes.

"Q. Will you hand it to the Notary Public, please? A. I will.

"Notary Public is requested to mark the Exhibit for identification, and it was marked Plaintiff's Number 4.

"Q. After you received this list, what did you do?

"A. I called Mr. H. L. Jones over the telephone and purchased 2,000 pounds of Yellow Globe Danvers onion seed from him at $2.50 per pound, for prompt shipment.

"Q. Did you communicate with Standard Seed Farms Company? A. Yes.

"Q. About when? A. October 20th, 1943.

"Q. Would you place the date as being within a few days after receiving the list?

"A. Yes, on October 20th, immediately on receipt of the list.

"Q. How did you communicate?

"A. By telephone.

"Q. To whom did you talk?

"A. Mr. H. L. Jones, Manager of the Standard Seed Farms Company.

"Q. State fully what you said and what he said, if you can.

"A. I told him that we had his surplus list, and we would purchase the 2,000 pounds of Yellow Globe

(Deposition of W. P. Stubbs.)

Danvers onion seed, at $2.50, which he quoted in the list at $3.00 per pound. He accepted the order for the 2,000 pounds of Yellow Globe Danvers onion seed and stated that he would ship same promptly. We purchased several other items from him at the same time, and I talked to him concerning those. I told him at the time that we only wanted first-class quality stocks of high germination and true to type, and he assured me that the stocks were of first-class quality and of high germination.

"Q. If you can't remember exactly what was said, tell us the substance of the conversation.

"A. I have answered this in the preceding answer.

"Q. Is there anything else that was said by either of you that you have not mentioned above?

"A. Nothing I can recall at the moment.

"Q. Was there anything said about limitation of liability? A. No.

"Q. Was there anything said about non-warranty? A. No.

"Q. Was there anything said about the possibility of the seed not being Yellow Globe Danvers?

"A. No.

"Q. What did you do next in regard to this sale?

"A. I confirmed the purchase by telegram, I believe on the same day, and the telegram was incorporated in the letter confirming the purchase.

"Q. Did you confirm the purchase of the Yellow Globe Danvers onion seed by telegram?

"A. Yes.

(Deposition of W. P. Stubbs.)

"Q. By letter? A. Yes.

"Q. What was the date of the telegram?

"A. I believe it was October the 20th, 1943.

"Q. What was the date of the letter?

"A. That was October the 21st, 1943.

"Q. Was the seed delivered to your company?

"A. Yes.

"Q. About when was it delivered?

"A. About October 28th, 1943.

"Q. How was it paid for?

"A. By our check drawn on the Colorado National Bank of Denver, Colorado.

"Q. Where was it paid for? That is, in what city?

"A. At the First National Bank in Denver, Colorado.

"Q. When did you receive the bill of lading?

"A. We received the bill of lading at the time the draft was paid on October 28th, 1943.

"Q. Was a draft used? A. Yes.

"Q. What kind of draft?

"A. Arrival draft.

"Q. What do you mean by an arrival draft?

"A. It is a draft payable on arrival of the merchandise.

"Q. Now, with reference to the time of payment of the draft, when did you receive the seed?

"A. The seed came in about the same time; I think it was October the 28th, 1943, to the best of my knowledge and belief.

(Deposition of W. P. Stubbs.)

"Q. In other words, the seed was shipped C.O.D.? A. Yes.

"Q. Was the seed paid for after it had been hauled to Denver? A. Yes.

"Q. Did you sell a portion of this seed to Dutch Valley Growers, Inc., of South Holland, Illinois?

"A. Yes.

"Q. How much did you sell?

"A. 1,000 pounds to Dutch Valley Growers, Inc., of South Holland, Illinois.

"Q. Did you ship the seed?

"A. Yes, the 1,000 pounds.

"Q. When did you ship the seed?

"A. Shipped during November, 1943, some time; I don't remember the exact date.

"Q. What seed did you ship?

"A. 1,000 pounds of the Yellow Globe Danvers onion seed received from Standard Seed Farms Company.

"Q. Did you ship the seed that you had received from Standard Seed Farms Company?

"A. Yes.

"Q. Did Dutch Valley Growers, Inc., pay you?

"A. Yes.

"Q. What was the result of this sale?

"A. The Dutch Valley Growers, Inc., complained to us some time after the sets were harvested and stored in the warehouse that the sets had started to sprout and were not keeping satisfactorily. They requested us to send someone to South Holland to inspect the sets grown from the seed which we

(Deposition of W. P. Stubbs.)

shipped them and which we purchased from the Standard Seed Farms Company. We then took the matter up with Mr. H. L. Jones, manager of the Standard Seed Farms Company, and advised them of the complaint and requested them to send someone qualified to inspect the sets. However, the Standard Seed Farms Company ignored the request and did not make any attempt to inspect the sets.

"Q. Was claim made against you?

"A. Yes.

"Q. What was the claim?

"A. They claimed that the Yellow Globe Danvers onion seeds we shipped them were evidently not Yellow Globe Danvers but some other variety which did not keep in storage and were badly sprouted. They also claimed that the sets grown from seed we shipped them as Yellow Globe Danvers onion seed were stored along with other sets of Yellow Globe Danvers onion seed purchased from other sources, and that the other Yellow Globe Danvers onion seed purchased from the other sources were keeping satisfactorily.

"Q. What did you do?

"A. We tried to see if Dutch Valley would make a reasonable compromise, but they refused to do so.

"Q. Did you invite Standard Seed Farms Company to do anything? A. Yes.

"Q. Did you invite H. L. Jones to do anything?

"A. Yes.

"Q. Did you attempt to settle the claim of Dutch Valley Growers, Inc.? A. Yes.

(Deposition of W. P. Stubbs.)

"Q. Were you able to settle the claim of Dutch Valley Growers, Inc.? A. No.

"Q. How much did they demand of you approximately? A. Approximately $35,000.

"Q. Did you ask H. L. Jones of Stockton, California, to settle this claim? A. Yes.

"Q. Did he do it? A. No.

"Q. Was a lawsuit filed against your company?

"A. Yes.

"Q. Do you know the number of this case?

"A. 1405.

"Q. What court was it in?

"A. In the United States District Court for the District of Colorado.

"Q. What was done after the lawsuit was filed?

"A. We still tried to make a reasonable settlement.

"Q. Was attempted settlement made?

"A. No.

"Q. Who defended the case?

"A. Huffman, Sutliff and Rogers.

"Q. Did H. L. Jones defend the case?

"A. No.

"Q. Did he participate in the defense of the case? A. No.

"Q. Was he asked to participate in the defense of the case? A. Yes.

"Q. Were you forced to employ attorneys to defend this litigation? A. Yes.

"Q. Whom did you employ?

"A. Huffman, Sutliff and Rogers.

(Deposition of W. P. Stubbs.)

"Q. What were your instructions to them?

"A. To handle the suit and defend it for Barteldes Seed Company.

"Q. Did you confer with the officers of your company in regard to his? A. Yes.

"Q. Did this meet with their approval?

"A. Yes.

"Q. Was this case defended? A. Yes.

"Q. By whom?

"A. Huffman, Sutliff and Rogers.

"Q. With what result?

"A. We lost the case.

"Q. Was a verdict and judgment rendered against you? A. Yes.

"Q. Approximately what was the sum of the judgment? A. $4,684.00.

"Q. What were the court costs?

"A. $322.26.

"Q. Did you pay these sums? A. Yes.

"Q. In addition to paying the judgment in the sum above referred to, were court costs and expenses involved in this matter? A. Yes.

"Q. How much were the court costs?

"A. $322.26.

"Q. How much were the expenses?

"A. $1,552.59.

"Q. I hand you herewith a document purporting to be a statement of attorney's fees and costs paid by your company in the matter of Dutch Valley Growers, Inc., vs. The Barteldes Seed Company, Civil Action No. 1405, United States District Court,

(Deposition of W. P. Stubbs.)

Denver, Colorado, and ask you if this refreshes your recollection? A. Yes.

"Q. Can you now state the total sum of expenses that you have now paid in the defense of said Civil Action No. 1405?

"A. The total sum of expenses paid in defense of Action No. 1405 are as follows: Judgment, $4,684.00; Court cost, $322.26; Expenses, $1,552.59; Attorneys' fees, $5,850.00; Grand total, $12,408.85.

"Q. How much were the attorneys' fees that you paid in this matter? A. $5,850.00.

"Q. Do you regard these as reasonable?

"A. Yes.

"Q. As necessary? A. Yes."

Mr. Rogers: If the Court please, I would like to offer in evidence at this time the surplus list identified by the witness whose deposition I just read.

Thursday, September 22, 1949—2:00 o'Clock P.M.

Mr. Rogers: The plaintiff's next witness, if the Court please, is Mr. Armin Barteldes of Barteldes Seed Company, Denver, Colorado.

ARMIN BARTELDES

called for the Plaintiff, sworn.

Direct Examination

By Mr. Rogers:

Q. Please state your name and address.

A. Armin Barteldes, 5650 West Thirty-eighth Avenue, Denver, Colorado.

(Testimony of Armin Barteldes.)

Q. What is your occupation, Mr. Barteldes?

A. I am in the seed business.

Q. What seed house?

A. Barteldes Seed Company.

Q. What is your position there?

A. Assistant Manager.

Q. In Denver? A. In Denver.

Q. Mr. Barteldes, how long have you been in the seed business?

A. Oh, all my life I have been working in it, about twenty-eight years.

Q. Was your father a seed man?

A. Yes.

Q. Of the Barteldes Seed Company?

A. Yes, sir.

Q. And your uncle?

A. My uncle originated it.

Q. How long has the Barteldes Seed Company been in business in Denver and Lawrence, Kansas?

A. In Lawrence about 82 years; in Denver about 65 years.

Q. Mr. Barteldes, what are your duties in your position in Barteldes Seed Company?

A. Working out some of the seed sales and also the onion sets.

Q. Mr. Barteldes, are you familiar with a variety known as the Yellow Globe Danvers?

A. Yes.

Q. In general, what is the Yellow Globe Danvers?

(Testimony of Armin Barteldes.)

A. It is an old standard variety of a light brown color, globe in shape.

Q. It is a type of onion?

A. Yes, definitely a type of onion, variety of onion.

Q. Is it known in the seed trade by that name?

A. Yes, sir.

Q. Mr. Barteldes, do you recall the purchase of 2,000 pounds of Yellow Globe Danvers seeds from Standard Seed Farms Company from Stockton, California, in the fall of 1943? A. Yes.

Q. Mr. Barteldes, I hand you herewith Plaintiff's Exhibit 4, and ask you to examine it, and ask you if you can state when the seed paid for by that draft was delivered in Denver, calling your attention to the stamps on the back.

A. The draft was paid on October 28, 1943, so the seed would have had to have been delivered at about the same time.

Q. Mr. Barteldes, did you have occasion to have any tests as to the variety of this seed made in the course of your duties at the office in Denver?

A. Yes.

Q. What tests did you have made?

A. I took a sample to one of our onion seed growers in Greeley, and he planted them along with his own varieties of sets as a check.

Q. Do you recall approximately when that was? I can refresh your recollection by the testimony of Mr. Werkheiser.

A. It should have been in 1945.

(Testimony of Armin Barteldes.)

Q. 1945. Do you recall approximately how much seed you took to Mr. Werkheiser?

A. I think I took about ten pounds.

Q. Who is Mr. Werkheiser?

A. He is our onion set grower in Greeley.

Q. And, if you know, what did he do with the seed, and what was the result of the tests?

A. He planted the seed in Greeley, and he harvested them when he harvested other sets. He kept part of them, and he sent part of them down to us.

Q. Were the sets stored?

A. We stored them in our warehouse.

Q. Did you examine these sets in the warehouse?

A. Yes.

Q. During the winter of 1945? A. Yes.

Q. Will you describe to the court the nature of your examination and the appearance of the sets generally?

A. Well, they were not Yellow Globe Danvers. They were a straw colored onion, and they had kind of green ribs on them. Something we had never grown before, or seen, and they didn't keep very well, they sprouted.

Q. Where did you get these seeds, Mr. Barteldes?

A. I got these seeds from the Standard Seed Farms.

Q. You weren't here this morning; the testimony this morning was that 1000 pounds of the 2000 pounds purchased from the Standard Seed Farms Company was sold to Dutch Valley Growers, Incorporated, of South Holland, Illinois. Do you know what became of the other 1000 pounds?

(Testimony of Armin Barteldes.)

A. Some we sold to Anderson Seed Company at Greeley, and some we sold to Peacock Corporation at Racine, Wisconsin.

Q. Did you have any complaints from either of those purchases?

A. We had complaints from Anderson of Greeleey. We weren't paid for the seed by Peacock, we never heard a word from him.

Q. What was the result of the sale of a thousand pounds to Dutch Valley Growers, Inc.?

A. We were sued for $30,000.

Q. Did you attempt to settle the case?

A. We were hoping to settle it, but didn't get around to it.

Q. As a result of the sale of this seed—I will withdraw that question. Was there any loss of good will as a result of the re-sale of this seed by your company?

A. In the Dutch Valley case——

Mr. Harkins: Just a moment. If the Court please, I object to that question as calling for a conclusion of the witness.

The Court: Well, it presents a legal question that probably you would want to argue on or brief later on. I am going to receive the evidence, and then I will consider it in connection with the legal problems that are finally presented to me.

Mr. Harkins: Thank you, your Honor.

The Court: It may be understood this line of questions are asked subject to the objections made.

(Testimony of Armin Barteldes.)

Mr. Rogers: What was your last answer before the interruption? I will ask the reporter to read it.

The Court: Did you suffer any loss of good will as a result of the purchase of this seed?

A. We have not been able to sell any onion seed or anything else to Dutch Valley.

Q. Where?

A. To the Dutch Valley Company.

Mr. Rogers: Peacock didn't pay you?

A. No.

Q. And Anderson of Greeley you mentioned, have you traded with him over a good many years?

A. Yes, we traded with him, he was quite a good customer of ours, and he kicked about it, but he never brought suit, we were afraid he would, but we have traded with him since.

Q. Mr. Barteldes, can you place any figure that would identify the loss of good will because of this resale, any figure in money of any kind?

A. Well, that would be pretty hard to put.

Q. You know there is a loss of good will, but you cannot identify it in terms of money?

A. That is right.

Q. Thank you, sir. Mr. Barteldes, there was testimony this morning that the Barteldes Seed Company—it is admitted that the Barteldes Seed Company paid $5,438 attorney's fees as a result of litigation arising out of the sale of this seed. Have you promised to pay any other attorney's fees in connection with the Dutch Valley Growers suit?

(Testimony of Armin Barteldes.)

A. We promised to pay Huffman $1,000.

Q. Have you paid it? A. No.

Q. When have you promised to pay it?

A. Any time that suits our convenience.

Cross-Examination

By Mr. Harkins:

Q. Your position is that of Assistant Manager of Barteldes Seed Company, is that correct?

A. Yes.

Q. Who is the General Manager, Mr. Stubbs?

A. Mr. Stubbs, yes, sir.

Q. Do your duties as Assistant Manager entail the receipt of shipments of seeds ordered from other growers or wholesalers? A. Do my duties?

Q. Yes. A. No, sir.

Q. Did you at any time in October of 1943 personally deal with Mr. Jones or Mr. Jones doing business as the Standard Seed Farms?

A. Personally, no, sir.

Q. You had nothing to do personally with the order for 2,000 pounds of onion seed?

A. No, sir.

Q. You aren't familiar with the conversation or the dealing between Mr. Stubbs and Mr. Jones of your own knowledge?

A. Just from hearsay.

Q. Now, you stated that certain tests were made of about ten pounds of onion seed in 1945 that you

(Testimony of Armin Barteldes.)

delivered to Mr. Werkheiser. Where did you get those ten pounds of seed?

A. Right out of the bag that came from Standard Seed Farms.

Q. You say it came right out of the bag that came from Standard Seed Farms. How could you tell it came from the Standard Seed Farms?

A. It had the lot number on it.

Q. Whose lot number?

A. Our lot number.

Q. Did you place that lot number on there?

A. No, sir.

Q. That was placed on there by one of your employees? A. Yes, sir.

Q. So you of your own knowledge don't know if that was delivered by the Standard Seed Farms to the Barteldes?

A. Well, I would swear to it.

Q. What?

A. I would swear to it, the way we keep our records and the books that we enter——

Q. You didn't keep the records yourself or place the lot number on there? A. No, sir.

Q. Do you know whether or not it is the practice of your company when shipments are received from growers or other wholesalers to remove their tags and place your lot numbers on there?

Mr. Rogers: I object to that as incompetent, irrelevant, and immaterial.

The Court: It certainly is material. It has to do with the identification. Overruled.

(Testimony of Armin Barteldes.)

Q. (By Mr. Harkins): Do you wish me to repeat that question, Mr. Barteldes?

A. No. We do, yes, we change the Standard Seed Farm label on a shipment like this thousand pounds that went to Dutch Valley, and put our own label inside the bag and our own tag on it.

Q. What do you do with the growers' or wholesalers' tags that came with the shipment?

A. We keep one in the file, probably, one tag.

Q. There is one inside the bag and one on the outside of the bag, is that correct?

A. Usually, yes.

Q. Now, is it the practice in your company when you assign a lot number to an assignment to keep those shipments separate from other shipments you receive from other growers?

A. Certainly—repeat that, your statement.

Q. Is it the practice in your company when you receive shipments from certain growers to keep those shipments separate? A. Yes.

Q. (By the Court): How do you identity those, give each a lot number?

A. We give each a lot number.

Q. (By Mr. Harkins): Did you remove the ten pounds from this bag of seed that you sent to Mr. Werkheiser? A. Yes, sir.

Q. ——or did one of your employees remove it?

A. I did.

Q. Who identified that as the Standard Seed Farms Company shipment?

(Testimony of Armin Barteldes.)

A. The lady that handles our garden seed department took me to the back room there where it was, and I knew what lot it was and I took it out myself.

Q. Did you have anything to do with the transaction with the Dutch Valley Growers in ordering that thousand pounds of onion seed from your company? A. No, sir.

Q. You had nothing to do with this shipment?

A. No, sir.

Q. Do you know whether those were shipped in the original bags or bags of your own?

A. In the original bags.

Q. How do you know that, Mr. Barteldes?

A. From the testimony of what the boys have told me.

Q. You don't know of your own knowledge?

A. I didn't see them, no, but I know what the bags looked like.

Q. Do you use similar bags to those used by the Standard Seed Farms Company?

A. They were in a seamless bag, but they weren't in the same type of bag as we usually have.

Q. Did you examine all the bags that were shipped to the Dutch Valley Growers?

A. No, sir.

Q. (By the Court): What were the distinguishing characteristics? A. Of the bags?

Q. Yes.

A. They had a different colored red stripe. We

(Testimony of Armin Barteldes.)

usually use the Fulton bag, that is the manufacturer of a seamless bag, and this was some bag we had never used before, and ordinarily we don't see.

Q. (By Mr. Harkins): Mr. Barteldes, were all of the other thousand pounds of seed sold, other than the thousand pounds sold to the Dutch Valley Growers? A. Not all, no.

Q. How much of the remainder of that thousand pounds were sold, do you know, approximately?

A. Well, I would say about 850.

Q. No suits have been filed against your company as to that 850 pounds of seed?

A. No, sir.

Q. How long had you been dealing with Anderson and Company prior to October of 1943?

A. Oh, he moved in there from Nebraska I would say five or six years before that.

Q. Had you sold any onion seed prior to that to him? A. I think so.

Q. Do you know whether you did or not?

A. No, I don't.

Q. Did you sell him any other kind of seed?

A. Yes, sir.

Q. Prior to October, 1943? A. Yes, sir.

Q. Have you had any dealings with Anderson since October of 1943? A. Yes, sir.

Q. The Peacock Corporation, had you dealt with them prior to October of 1943? A. Yes, sir.

Q. Have you dealt with them since October of 1943? A. No, sir.

(Testimony of Armin Barteldes.)

Q. What had you sold them prior to October, 1943, if you know?

A. Oh, Mr. Stubbs—he sold the onion seed. He purchased other small garden seed.

Q. Those were the only two companies that you have had any complaints from relative to the onion seed? A. Yes, sir.

Q. Your other business has been the usual up and down, garden or surplus seed, and such as that, since October, 1943? A. I don't understand.

Q. What has been the trend of your business since October of 1943, has it been average, increased, or decreased?

A. Well, it has been about the same, maybe a little bit better.

Q. Did you ever deal with the Dutch Valley Growers prior to October, 1943?

A. I think we had, yes.

Q. Well, are you sure, or do you know?

A. I don't know. I didn't sell him onion seeds——

Q. That is what I am trying to find out.

A. I haven't dealt with them on the onion seeds. I have dealt with them for some time——

Q. You wouldn't know, Mr. Barteldes, when this seed was ordered from you by the Dutch Valley Growers, whether the seeds were going to be used for sets or what they were going to be used for?

A. No.

Mr. Rogers: If the Court please, that is irrelevant.

(Testimony of Armin Barteldes.)

Q. (By Mr. Harkins): Your testimony is, Mr. Barteldes, you have been in the seed business for at least 20 or 25 years? A. Yes.

Q. You are familiar with the general custom and usage in the seed business throughout the United States?

Mr. Rogers: If the Court please, I wish to strenuously object to this as outside the direct examination.

The Court: Yes, it is outside the direct examination.

Mr. Harkins: That is all, your Honor, unless my associate has a question.

Q. (By Mr. Cronin): Mr. Barteldes, when did you receive the seed from Mr. Jones?

A. When?

Q. Yes. A. Oh, in October, 1943.

Q. And when did you give Mr. Werkheiser the ten pounds to take for a sample?

A. I think that would be in 1945.

Q. That would be two years later?

A. Yes.

Q. Now, about these tags, these identification tags, what are on those tags?

A. The name and the variety and the lot number.

Q. Is there any other printing on those tags? If I showed you a tag, could you identify it?

A. Yes.

(Testimony of Armin Barteldes.)

Q. I hand you what purports to be an identification tag, and ask you to look at it and examine it and see if that is the usual tag that accompanies a shipment of seed?

Mr. Rogers: If the Court please, we are interested in the identification of the variety received by the Barteldes Seed Company. I don't want any misunderstanding to come in by the cross-examination of my witness.

The Court: I don't know what the purpose of this is until the witness answers.

Q. Do you identify that tag?

A. This is a Standard Seed Farms Company tag. It is different from our stock tag that I think you were asking me about.

Q. (By Mr. Cronin): I am asking if these are the type of tag that accompanied all shipments of seed that you purchased from other companies. Do they have that type of tag? A. No.

Mr. Pierce: Just a moment. I object to that as not proper cross-examination.

The Court: What is the purpose of it?

Mr. Cronin: I wanted to identify that as the usual type of tag on the seed.

Q. (By the Court): Let me ask you, did you see the tags that originally accompanied these seeds?

A. No.

Mr. Cronin: That is all.

Mr. Rogers: No further questions. That is all the testimony we have, your Honor.

I would like to offer in evidence at this time the telegram of October 20th from the Barteldes Seed Company to Standard Seed Farms Company, identified at the pre-trial as Plaintiff's Exhibit for identification.

The Court: Under the stipulation entered into at the pre-trial, it will be received.

(Telegram from the Barteldes Seed Company to Standard Seed Farms Company dated October 20, 1944, was marked Plaintiff's Exhibit Number 5.)

Mr. Rogers: And also Plaintiff's Exhibit for identification Number 6, the letter of October 21 from the Barteldes Seed Company to Standard Seed Farms Company insofar as it is material to the case.

The Court: Received.

(Letter from Barteldes Seed Company to Standard Seed Farms Company dated October 21, 1943, was marked Plaintiff's Exhibit Number 6.)

Mr. Rogers: I should also like to offer in evidence a letter from H. L. Jones of the Standard Seed Farms Company to the Barteldes Seed Company dated October 21, 1943, which has not previously been identified, it had been mislaid. I am going to ask counsel for a stipulation that it may be used without foundation. Otherwise, I will call Mr. Jones to identify it.

Mr. Pierce: Do I understand, your Honor, that all the exhibits at the pre-trial that were stipulated to are now in evidence?

The Court: Well, I will have to look at the pre-trial order.

Mr. Pierce: If they are not in evidence, as a matter of technical record I would like to offer them in evidence at this time and ask that they be appropriately marked.

The Court: If there is no objection, they will all be received.

Mr. Rogers: Do you have objection?

Mr. Harkins: No.

(Document entitled "Contract Price List, Vegetable Seeds, Season of October 18, 1943, Surplus 1943 Crop, Standard Seed Farms Company," was marked Plaintiff's Exhibit Number 7.)

(Stipulation in case of Dutch Valley Growers, Inc., vs. the Barteldes Seed Company, was marked Plaintiff's Exhibit Number 8.)

(Letter from Standard Seed Farms Company to the Barteldes Seed Company dated October 21, 1943, was marked Plaintiff's Exhibit Number 9.)

Mr. Pierce: Your Honor, that is our case, with the exception of a fact that we have been discussing with counsel and which we believe can be covered by a stipulation after the 3:00 o'clock recess, or during the 3:00 o'clock recess. Is that agreeable with you, Mr. Harkins?

Mr. Harkins: That is agreeable.

Mr. Pierce: That will save a lot of time. I think it will be stipulated, so we can reopen our case after the 3:00 o'clock recess for the purpose of putting in a stipulation.

The Court: Very well.

Mr. Harkins: Will you take the stand, Mr. Jones?

HUGH L. JONES

called for the Defendant, sworn.

Direct Examination

By Mr. Harkins:

Q. Your full name is Hugh L. Jones?

A. Yes.

Q. And prior to and during October of 1943 and subsequent thereto you operated a business known as the Standard Seed Farms Company?

A. Yes, I did.

Q. Will you state whether that was a corporation, a partnership, or what was the nature of the business set-up?

A. It was an individual doing business under that name.

Q. That is——

A. Myself, doing business under that name.

Q. How long have you been in the seed business, Mr. Jones?

A. Approximately about thirty-two years—thirty years, at least.

(Testimony of Hugh L. Jones.)

Q. And when did you start business as the Standard Seed Farms Company? A. About 1916.

Q. Prior to 1916, you had been in the seed business work or employment?

A. I worked for another company prior to that for approximately three years.

Q. What kind of work were you doing there?

A. General field work, supervising crops and so forth, pertaining to the raising of vegetable seeds.

Q. And the Standard Seed Farms Company, what type of seed business did they engage in primarily?

A. Primarily vegetable seeds. You might say exclusively vegetable seeds.

Q. Is that growing and selling or growing or selling?

A. The growing as well as the process and sale of vegetable seeds.

Q. Now, in the conduct of this business you dealt with customers both in California and in the various parts of the United States?

A. Very near all states.

Q. How do you solicit your business from the various wholesalers and seed concerns?

A. Sometimes we would make personal calls, on the majority of them that we can do economically. Sometimes we sent out lists of what we have to offer.

Q. When you say "lists" is that price lists or surplus lists?

A. Yes, a price list of what you have on hand and what you wish to dispose of.

(Testimony of Hugh L. Jones.)

Q. Is it similar to the surplus list that was contained in the—well, I will show you a copy of it here, Plaintiff's Exhibit 7, Mr. Jones, and that is the surplus list that was contained in the deposition of Mr. Stubbs.

A. Yes, that is the same list.

Q. Is that the general practice in the seed business, to solicit business by surplus lists or price lists?

A. That is the general practice.

Q. Now, prior to October, 1943, did you—I will show you Plaintiff's Exhibit Number 7 again, with which you are familiar, you mailed that to the Barteldes Seed Company, isn't that correct?

A. Yes.

Q. That is a copy of an original that you mailed out? A. Yes.

Q. As a result of that did you receive—or, rather, did you have any business dealings with the Barteldes Seed Company?

A. I received a telephone message from Mr. Stubbs of the Barteldes Seed Company on or about October 20th.

Q. And what was the telephone message concerning?

A. It was—after the usual amenities he said he was interested in buying a ton of Yellow Globe Danvers onion seed, some south port Yellow Globe onion seed, also some celery seed, some Ebenezer seed, and some radish seed. That is all I can recall.

Q. And did you enter into any business deal with him at that time?

(Testimony of Hugh L. Jones.)

A. Yes, sir. Mr. Stubbs called my attention to the price we had on Yellow Globe Danvers that was quoted to him as $3.00 a pound, and he objected to it, stating that he didn't think he would be interested in that price, and after considerable jockeying, you might say, back and forth, he offered $2.50 a pound for it.

Q. Did you accept that offer?

A. I accepted that offer.

Q. Was there any further conversation with Mr. Stubbs relative to the purchase of onion seed?

A. Yes. He went into detail as to how he wanted it shipped. He notified, or, rather, told me that he wanted it shipped over the P.I.E.—I think that is the Pacific Intermountain Express, a trucking concern. He stated in doing that he wished to avoid getting the shipments mixed up with war shipments which were very heavy at that time, and he wanted shipments very promptly and delivery as promptly as we could possibly get it, and we agreed to deliver it as he directed.

Q. In your telephone conversation with Mr. Stubbs was there any mention made as to the manner of shipment—the manner of payment of the seed in question?

A. I have already stated the manner of shipment, and on the matter of payment, I told Mr. Stubbs that inasmuch as we were making what we thought was a terrific concession in price, that we should have our money as early as possible, and he told me at that time to ship—no, he said he would

(Testimony of Hugh L. Jones.)

air mail a check on it immediately upon the receipt of the invoice, or I could ship it draft.

Q. Was there any discussion as to the payment of freight rates on that shipment?

A. No, there was no discussion in regard to the payment of freight rates, because it is customary that the buyer of garden seeds, since I have been connected with the business, for the buyer to pay the freight from the point of origin. I have never known a shipment otherwise.

Q. Did he state that the shipment could be f.o.b. point of origin, or f.o.b. point of destination in the telephone conversation?

A. Shipment was to be f.o.b. Stockton.

Q. In that telephone conversation you were in Stockton, California, is that correct?

A. Yes.

Q. And he identified himself as being in Denver in the telephone conversation?

A. That is where he wanted it shipped.

Q. I want to refresh your recollection, Mr. Jones, —you were here this morning when Mr. Stubbs' deposition was read—may I have your copy of that? I don't have the answer in full there. In answer to interrogatory number 24, there was read into the record, Mr. Jones, the telephone conversation you had with Mr. Stubbs in answer to the question as to what was said:

"I told him that we had his surplus list, and we would purchase the 2,000 pounds of Yellow Globe Danvers onion seed at $2.50, which he quoted in the list as $3.00 per pound. He accepted the order for

(Testimony of Hugh L. Jones.)

the 2,000 pounds of Yellow Globe Danvers onion seed and stated that he would ship the same promptly. We purchased several other items from him at the same time, and I talked to him concerning those. I told him at the time that we only wanted first class quality stocks of high germination and true to type, and he assured me that the stocks were of first class quality and of high germination."

A. I don't recall any of that conversation. As I remember, I would say probably 95 per cent of it was devoted to jockeying between the price of $3.00 and $2.00 a pound.

Q. You didn't pay the freight for the shipment?

A. Oh, no, that is not customary.

Q. The freight was delivered to the Independent Freight Lines Depot at Stockton, California?

A. Yes.

Q. The Pacific Intermountain Express did not have a terminal at Stockton?

A. I inquired from the Stockton office if I could deliver it to his building here, and he said I would have to send it to Sacramento and P.I.E. would have to pick it up near Sacramento or at Sacramento.

Q. So it was delivered by you to the Independent Freight Lines?

A. It was delivered to the Independent Freight Lines.

Q. The 2,000 pounds of onion seeds, Mr. Jones, in what type of bag and what brand of bag was that seed contained? A. What type of——

(Testimony of Hugh L. Jones.)

Q. What type of shipping bag, will you describe to the Court the type of container?

A. As a rule, that was packed in Cincinnati seamless A two-bushel bags, and they were double bags.

Q. And they are hundred pound bags, or two hundred pounds?

A. They have about a hundred to 102 or 103 pounds a bag.

Q. The 2,000 pounds of onion seeds, where were they grown?

A. They were grown in Stockton, San Joaquin County.

Q. They were grown under your supervision?

A. Yes.

Q. How was that seed brought into your warehouse and sacked and shipped?

A. It is brought into the warehouse after the usual threshing procedure for preliminary treatment, removed from the warehouse, washed, dried, and sacked, and returned to the warehouse for final cleaning and packing in the warehouse, and a label is put on—one part of that label is inside the bag, the other part is outside the bag. Then a lot number is put on that label and the percentage of germination and percentage of purity is put on that label—the amount of germination on that was 90 per cent—that appeared on the bag, and approximately that is all.

Q. Your various types of onion seed, if you are growing more than one type, how are they kept separate in your warehouse?

(Testimony of Hugh L. Jones.)

A. Well, there is an inflexible rule there I never allow more than one type of onion in the warehouse at the same time—that is, in the cleaning department of the warehouse at the same time. That was for the purpose of avoiding mixtures and—well, mixtures.

Q. And do you recall how much tonnage of onion seed that you grew in 1943?

A. In that particular lot, as near as I can recall it, there was something like 3200 pounds.

Q. And was that all Yellow Globe Danvers?

A. That was all Yellow Gobe Danvers.

Q. 2,000 pounds of which were sold to the Barteldes Seed Company?

A. That went on the Barteldes Seed Company order.

Q. And did you dispose of the other thousand pounds?

A. Oh, yes, that was disposed of to various customers.

Q. I am going to show you here, Mr. Jones, a tag, presumably a shipping tag, and ask you if that is the type of shipping tag that was used in your shipments to Barteldes Seed Company in October—on or about October 23, 1943?

Mr. Rogers: If the Court please, I think this is directed not towards the shipping tag, but to some material on the shipping tag. The shipping tag itself I have no objection to, but I can't see the materiality.

(Testimony of Hugh L. Jones.)

The Court: It may be leading up to something.

Mr. Harkins: Yes, it is, your Honor. I have a purpose.

Q. Is that the type of shipping tag that was used in your——

A. That is the type of shipping tag that covered all shipments. One of these tags were attached to each and every bag. The lower half of that tag went into the inside of the bag, the upper half went on the outside of the bag.

Mr. Harkins: I am going to ask that be marked for identification Defendants' Exhibit next in order.

(The document referred to was marked Defendant's Exhibit B for identification.)

Q. (By Mr. Harkins): How was the 2,000 pound shipment of seed to the Barteldes Seed Company paid for, how did they pay for it?

A. They paid our draft, sight draft.

Q. I am going to show you, Mr. Jones, Plaintiff's Exhibit 6, and ask you if that is the letter of confirmation which you received from the Barteldes Seed Company subsequent to your telephone conversation with Mr. Stubbs?

A. That is the letter of confirmation.

Q. Did that follow Plaintiff's Exhibit Number 5, the telegram of confirmation sent to you by Mr. Stubbs of Barteldes Seed Company? A. Yes.

Q. Did you follow the instructions thereon and ship the seed f.o.b. Stockton, California, and send the invoice to the Barteldes Seed Company?

(Testimony of Hugh L. Jones.)

A. I did.

Q. Shipper's order bill-of-lading with the draft drawn on——

A. Shipper's order bill-of-lading with the draft attached.

Q. You had had previous dealings prior to October 20, 1943, had you, with the Barteldes Seed Company?

A. Our first dealings with the Barteldes Seed Company I think dates back to 1918, when the Barteldes Seed Company were buying seed out of Lawrence, Kansas, and it continued intermittently —not very steadily, but intermittently it continued up to the time of this shipment of October 20, 1943.

Q. Why did you use that shipper's order bill-of-lading with the draft attached, Mr. Jones?

A. Well, in discussing this deal, it was a matter of using that money in a hurry, and we wanted security for the payment of the seed we were sending him, it was a large order, something which we didn't wrestle with every day, and we sent it to protect that interest. We sent it through the bank with the shipper's order attached to the draft, which is customary in such circumstances.

Q. Now, you stated you have been in the seed business since 1916, and you are familiar, are you not, Mr. Jones, with the general custom and usage throughout the seed trade in the State of California and in other parts of the United States relative to disclaimer clauses in the sale of seed, are you not?

A. I am.

(Testimony of Hugh L. Jones.)

Q. And isn't it true, Mr. Jones, that there is a general custom in the seed trade in the State of California not to warrant either the description or the quality or the productiveness or any other matters dealing with the sale of seed?

Mr. Pierce: Just a minute, please, before you answer. We object to that question upon the ground first of all it is leading and suggestive, but more particularly on the ground——

The Court: That is far enough. I sustain it on that ground, as leading and suggestive.

Q. (By Mr. Harkins): Mr. Jones, are you familiar with any general custom or usage in the State of California relative to disclaimer clauses or non-warranty clauses in the State of California?

A. Yes.

Mr. Pierce: Just a minute. I object to that question on the ground it is calling for evidence upon a fact not relevant in this case——

The Court: I am going to receive it, Mr. Pierce——

Mr. Pierce: Yes, your Honor.

The Court: Subject to your objection to its relevancy, and I will consider it later on.

Mr. Pierce: And may it be considered all these questions relating to custom and practice in variance with what we claim to be the practice are objected to?

The Court: Very well. I think counsel submitted some authorities with respect to the matter that the Court can take judicial notice of the practice.

(Testimony of Hugh L. Jones.)

Mr. Harkins: I did, your Honor, on our motion to strike.

The Court: I will receive it subject to the objection. All objections to custom are deemed to have been made on the ground of materiality.

Mr. Harkins: You are familiar with the general custom in the seed business in the State of California? A. Yes.

Q. Relative to disclaimer clauses and non-warranty clauses? A. Yes.

Q. Mr. Jones, do you know what that custom is?

The Court: And was during the period of 1943.

Q. (By Mr. Harkins): During the period of 1943; in other words, during the period this sale was made to Barteldes Seed Company of 2,000 pounds of Yellow Globe Danvers.

A. That, I would say, was the universal custom.

Q. What was the custom?

A. That was the universal custom.

Q. (By the Court): What was the custom?

A. The non-warranty of seed you sell.

Mr. Harkins: As to what, Mr. Jones?

A. As to productiveness or any other matter of that seed.

Q. As to quality?

A. As to quality, productiveness——

Mr. Pierce: Please don't—may it please the Court, this witness is testifying as an expert, and I think he knows more about it than his counsel. I am going to object to it as leading.

(Testimony of Hugh L. Jones.)

The Court: I think it is inappropriate to lead him on this.

Mr. Harkins: I am sorry, your Honor.

The Court: Any further elaboration you wish to make on your answer?

A. Your Honor, that is the universal custom adopted before my time, which I think was 1918 when I first went to work with the California Seed Growers Association, one of the first things they told me, never let a bag go out of the warehouse unless it was properly labeled and that label had on it the usual seed man's disclaimer. That was back in 1918.

The Court: You say the usual seed man's disclaimer?

A. That was the accepted wording that the seller of these seeds gives no warranty as regards the purity, productiveness, or any other matter connected with the sale of seed, the productiveness of the product, we are not in any way being responsible for the product. That is accepted and endorsed by the American Seed Trade Association, an association that covers every state in the United States.

Mr. Harkins: I think that is all, Mr. Jones—just a moment. That is all.

Mr. Pierce: Your Honor, do you wish us to begin our cross-examination?

(Recess.)

Mr. Pierce: Your Honor, counsel for both sides have reached a stipulation that in the case which has been referred to in the United States District Court of Denver in which the Dutch Valley Growers——

The Court: The civil action?

Mr. Pierce: The civil action, in which the Dutch Valley Growers were plaintiff and Barteldes was defendant, an answer was filed which raised all of the defenses and all of the issues alleged by the complaint excepting the sale of the quantity of seed in question, which, of course, is admitted, and that these issues were defended by the defendant in that case at that trial.

That stipulation is for the purpose of filling a gap which now exists.

We have offered in evidence at the pre-trial conference all of the other pleadings in that action, but we omitted the introduction of the answer and the stipulation is to cover that and make whole the proceedings in connection with that case.

Mr. Harkins: That stipulation is satisfactory, your Honor.

The Court: I believe you have reached the cross-examination.

Cross-Examination

By Mr. Pierce:

Q. Mr. Jones, I wish that you would describe for me with a little more detail the lay-out of the property which you have referred to as your home

(Testimony of Hugh L. Jones.)

ranch at Stockton, with reference to the way the fields are arranged——

A. I beg you pardon?

Q. ——the way the fields are arranged in which onions were grown in 1943.

A. The ranch consists of 180 acres, it runs east and west. On the south side is Hammer Lake. It is not a right angle, it is inclined a little bit. The west side is about a thousand feet wider than the east end. The seed was produced at that time with some at the east end of it, some of it in the west end, and, as I recall, a little on the south side.

Q. Approximately how many acres at that time, with reference to the particular seeds which are involved in this case, how many acres were then being grown to Yellow Globe Danvers seed?

A. I think about eight and a half acres.

Q. And where were those eight and a half acres located with reference to the fields you have described?

A. They were towards the west end.

Q. How many acres altogether of all types of onions were you growing at that time?

A. They were planted about 50 to 55 acres on the extreme west end, and that eight and a half acres were on the east end and the southern end, I think the south side had a few acres. I think that is all, but I am not positive about that.

Q. Is my understanding correct, then, that the particular acreage of onions which were grown to Yellow Globe Danvers at that time was separated

(Testimony of Hugh L. Jones.)

entirely from the acreage which was grown to the other types of onions? A. Oh, yes.

Q. Were the onions reaching maturity at the same time of the year?

A. Approximately, within a week or ten days.

Q. Will you describe with a little more particularity, if you will, please, how you harvested the seed of these onions and brought it to the warehouse?

A. The first process in harvesting onion seed is to take the ball, which is done by hand. These little balls or seed heads are placed in a bag which is attached to the picker by a loop around his neck or his waist. When they are filled, they are taken to a truck at the head of the road, dumped into a larger bag, which holds about four or five times the single bags. When the truck is filled, those bags are taken to the drying and cleaning yard on the south side and away from all others, and those heads are dumped out on canvas sheets. These particular canvas sheets we used were about 30 by 30 feet. The ball is left there from approximately 12 to 15 days, depending upon the weather, whether it is warm or cool, until they are thoroughly dried. Then they are threshed and the refuse is raked off.

Q. Where are they threshed, in a warehouse, or out in the open?

A. No, they are threshed on the sheets. The process of threshing is rolling. When the material is rolled down sufficiently, we take a rake and rake off the large parts of the stems or the upper part

(Testimony of Hugh L. Jones.)

of the stem, and they are brought into the mill and cleaned.

Q. And that is what is known as the cleaning process?

A. That is what is known as the preliminary cleaning process.

Q. That is done, you say, in a mill?

A. That is done in a mill.

Q. Is that mill adjoining your drying yard?

A. In this case it is about 200 yards.

Q. I believe you testified in respect to some questions on direct examination as to the separate types or kinds of onions that are cleaned at the same time, or you have instructions to that effect. Did you mean by that that they are cleaned in this preliminary process you have described at the same time?

A. At any time when we have one variety of onion seed to clean, whether it is the initial cleaning or preliminary cleaning, another variety, no matter how similar or how different, is never brought into the mill, it is left out in the field.

Q. However, during this process when it is left out on the sheets you have mentioned in the drying yard, are there several varieties left in the drying yard at the same time, prior to bringing them into the preliminary cleaning place?

A. Yes, whatever variety you have for cleaning, but they are kept separate, perhaps 50 to 60 feet between the sheets.

Q. Is there any other method of designating or keeping them separate? A. Is there——

(Testimony of Hugh L. Jones.)

Q. Let me withdraw that question. It is clumsily expressed. Are there any other means of designating those as separate varieties, except by keeping them in separate piles?

A. You see, these sheets are all continguous, they overlap, the head of the sheet has a tag sewn onto it.

Q. What?

A. The head of the sheet has a tag sewn onto it.

Q. I didn't hear that one word.

A. A tag sewed on it.

Q. A tag sewed on it, s-e-w-e-d? A. Yes.

Q. All right. And what does that tag say?

A. That tag has the lot number on it and the variety of the seed.

Q. Now, do you handle this personally yourself, or do you have a foreman?

A. Oh, no, I do all the supervisory work attached to this business. It is strictly a one-man concern. The only labor I hire is the labor that does the actual manual, what we call stoop labor.

Q. Do you have a foreman?

A. Well, he might designate himself as a foreman, if I give him instructions to tell the other boys to do this or that, he might classify himself as a foreman, but I don't classify him as a foreman.

Q. Obviously, Mr. Jones, you can't be present every hour of the day every day.

A. I would like to call your attention to the fact that I live on that ranch.

Q. I beg your pardon?

(Testimony of Hugh L. Jones.)

A. I would like to call your attention to the fact that I live on that ranch.

Q. Yes, I understand.

A. And I kept very close supervision over everything that went on on that ranch.

Q. I understand that, but you are not, of course, there twenty-four hours a day, nor were you there at every hour of the operations, that is obvious, and there must have been somebody there in charge when you were forced by business or otherwise to leave.

A. Not when there was anything in connection with the seed or processing seed.

Q. Is it fair to state that you were in charge when every single bag of seed was brought in and placed on the sheets that you have described?

A. No.

Q. If you weren't there, who was in charge of that? A. Can I give you an example?

Q. If it is going to clarify it, certainly.

A. I hope that it will. When I would like to take that seed and move the seed, I would put a boy on it and he would go down the field with four or five assistants, if necessary, if not necessary, only one, and he would lift those piles at the head of the row and put them on the truck, and I wouldn't let them sack two different varieties, so they wouldn't make a mistake by going in there and moving the wrong pile.

Q. All right, I think you have made that quite clear. How long was this process by which the onions were kept out in the drying yard—a shorter

(Testimony of Hugh L. Jones.)

way of saying it, how long is the drying process?

A. That operation might take a month, it might take six weeks, it might take five weeks before they came in the mill, depending on what we had in the mill and what they were running.

Q. During this period of time were those seeds in sacks on the sheets, or were they in bulk on the sheets?

A. Well, we will go back to the process again. When the sheets are rolled—some called it threshed, it is the same thing in the long run, it is left there until the boys get ready to sack it, then it is sacked up and waits the truck to take it to the mill. Does that answer your question?

Q. I think so. Then it would be in bulk for a period of time of about a month, is that correct?

A. Yes.

Q. Now, at this time, and I am referring to the time that the seed that you subsequently sold to Barteldes was being dried, how many varieties of onions were grown on your home ranch?

A. I think there were three varieties.

Q. Three varieties?

A. Yellow Globe Danvers, early Yellow Globe, and, as near as I can recall, there was a little White Globe, not very much White Globe.

Q. What color of onion would be the White Globe?

A. The White Globe, as its name indicates, would be a white color.

Q. Is it a bright white?

A. Yes, sir, waxen white.

(Testimony of Hugh L. Jones.)

Q. And the other types you have mentioned, what color? A. They are yellow.

Q. Is there any difference between the early Globe and the Stockton Yellow Globe?

A. The early Globe is a little darker than the Stockton Yellow Globe.

Q. Mr. Jones, I am going to show you this photostatic copy which you were shown on direct examination, I believe it is a photostatic copy of Plaintiff's Exhibit Number 7. Isn't this, Mr. Jones, just a form of printed contract which you were then using under the terms of which you agreed to grow seeds for various purchases?

A. That is correct, modified by those words, "Surplus 1943 crop." If you put the word "surplus" on there it is not an agreement to grow.

Q. In other words, in this particular case, in lieu of furnishing a regular price list, you used one of your contract forms and distinguished it by putting the word "surplus" on it, is that right?

A. It amounts to the same thing.

Q. It wasn't exactly the same, was it, as your usual price list?

A. It is about the same as my usual price lists.

Q. Well, do you use this all the time as a price list? A. Yes.

Q. Do you use that form? A. Yes.

Q. I believe you testified on direct examination that 3200 pounds was the total of your crop of Yellow Globe Danver onions grown or in the warehouse at the particular time that you made this sale to the Barteldes Seed Company?

(Testimony of Hugh L. Jones.)

A. As near as I can recollect, that was the testimony and that was the fact.

Q. Wasn't it a fact that the quantity was 4,000 pounds or 4100 pounds?

A. Well, now, let me see, I don't say—I think it was more like——

Q. I want to call your attention to——

A. It may be, I couldn't say definitely.

Q. You remember when your interrogatories were taken of this case, Mr. Jones? Well, let me shorten this up. Didn't you state when your interrogatories were taken that the quantity was 4100 pounds?

A. Well, you will have to read it. I couldn't remember all this.

Q. Well, would you like to read that yourself?

A. Yes.

Q. This is the statement to which I refer (submitting document to witness).

A. Well, that is on the scale.

Q. All I am trying to do is find out which was correct. Do you now recall there was 3100 pounds or 4200 pounds?

A. That happened six years ago——

Q. I can readily understand, Mr. Jones, and my purpose of impeachment is not to discredit your statement, it is solely to ascertain whatever your correct recollection is at this time.

A. That may be a little under and what my testimony was a few minutes ago may be a little over. I said approximately.

(Testimony of Hugh L. Jones.)

Q. Then it would be a fair understanding of what you now recall it was somewhere between 3200 and 4200 pounds? A. Yes.

Mr. Pierce: All right, thank you. May we have about a one minute recess while I discuss something with counsel here?

Your Honor, that is all from this witness.

Mr. Harkins: No further redirect examination.

Mr. Voorhies, will you take the stand, please?

CYRUS F. VOORHIES

called for the Defendant, sworn.

Direct Examination

By Mr. Harkins:

Q. Mr. Voorhies, what is your business?

A. Seed grower.

Q. And are you engaged in business for yourself, or are you employed by someone?

A. At the present time for myself.

Q. And where is your business located, Mr. Voorhies? A. 30 Davis Street, San Francisco.

Q. And how long have you been in the seed business, Mr. Voorhies? A. Thirty years.

Q. In various capacities in the seed business, or would you relate the capacities?

A. Well, I was the President of the corporation and my son and I bought it out here about nine or ten years ago, so my son and I have conducted the business as partners and I have been the President and the Manager.

(Testimony of Cyrus F. Voorhies.)

Q. What is the name of that business?

A. Sherwood Seed Company.

Q. Located at 30 Davis Street, San Francisco?

A. Yes.

Q. And prior to that time were you employed by any other companies? A. No.

Q. And at times in the seed business have you been in the growing part of the seed business, as well as the selling?

A. Well, we grew and then sold what we grew. We were known as growers.

Q. Your principal business, is it wholesale or retail? A. Wholesale.

Q. And is it principally what is known as the garden seed business?

A. Vegetable seed, yes.

Q. Vegetable seed, rather than the field?

A. Yes, no field.

Q. Have you been engaged in sales in the State of California, as well as other parts of the United States?

A. Yes, but our principal business has been outside of California, the large majority of it.

Q. Are you familiar, Mr. Voorhies, with the general custom and usage of the seed trade, both in the State of California and in other parts of the United States relative to disclaimer and non-warranty clauses?

The Court: During the year 1943.

Mr. Harkins: During the year 1943. I am sorry, your Honor.

A. Yes.

(Testimony of Cyrus F. Voorhies.)

Q. Will you state briefly to the court what that custom and usage as to disclaimer and non-warranty was during the year 1943?

Mr. Rogers: It is understood our objection is of record, your Honor?

The Court: Yes. You may answer. What was the custom in 1943?

A. Well, the custom has always been, including, of course, 1943——

The Court: In what territory is this?

A. In the United States of America, that it is printed on all, I think practically all that I have ever come in contact with seeds——

Mr. Harkins: We are not interested in what is printed. I am asking what the custom is.

A. Oh, the non-warranty, that you don't guarantee the productiveness of the seed sold; that is, the productiveness, et cetera, et cetera.

The Court: "Et cetera" means what?

Q. (By Mr. Harkins): Be more particular, Mr. Voorhies.

A. The productiveness and the other—varieties, type, et cetera, beet, carrot, lettuce, parsnip, anything that we sell. That has been in existence before my time—it may have been corrected in language several times in the association—I might add, if I might, that there is one national association of seed men, there is a state association, and there is regional associations, and, of course, they have their attorneys, and the American Seed Trade Association, I

(Testimony of Cyrus F. Voorhies.)

guess, was the ones that years ago thought out this non-warranty clause that was brought up through the attorneys of the association, and I guess it has been tested time and time again, I don't know the exact details of the cases, but that is the custom of the trade, whether they are members of any association or just in the seed business, and I believe that applies to everybody in the seed business, retailers, wholesalers, growers, everybody.

Q. Are you a member of the, I believe it is known as the American Seed Association?

A. American Seed Trade Association.

Q. American Seed Trade Association, you are a member of that? A. Yes.

Q. Did you ever hold any position in that association? A. Yes, I was President.

Q. In what year was that? A. 1939.

Mr. Harkins: That is all, Mr. Voorhies.

Cross-Examination

By Mr. Rogers:

Q. Mr. Voorhies, has the custom to disclaim that you have mentioned been changed from year to year in your experience?

A. In my experience, I think it has been changed once that I know of.

Q. When was that?

A. Oh, I think it was 1942, 1943, or 1944.

Q. 1942, 1943, or 1944?

A. I am not sure, I am not positive, I can't give you the date. I know that sometime on account of

(Testimony of Cyrus F. Voorhies.)
that change we had to have our stationery reprinted, but whether it was three years ago or six years ago I am not sure.

Q. What was the change?

A. We wouldn't be responsible for more than the invoice price of the seed.

Q. What was the old?

A. Wouldn't be responsible in any respect. If I would have known you would have asked that question, I would have brought you the exact wording. I can't tell you exactly word for word, but that is the substance of the change.

Q. Why was the change made?

A. That I don't know. That was made by the attorney and the Legislative Committee of the American Seed Trade Association. I couldn't tell you who was the chairman, I don't know. I wasn't active after I was past president.

Q. That was two years after you were president of the American Seed Trade Association?

A. I don't know the date. 1939 I was president.

Q. You say it was changed probably in 1942 or 1943? A. It may have been.

The Court: Mr. Voorhies, on direct examination you testified to what the custom was in 1943. Now, are you mistaken? Was the change made so that the change was in effect in 1943?

A. Well, your Honor, I had reference to the disclaimer, that was in effect. It has been in effect ever since before my time, but the wording of it, I couldn't tell you what the exact change or the exact date was.

(Testimony of Cyrus F. Voorhies.)

The Court: Well, the change is quite important. You told me what the custom was in 1943. Now, you say there was a change made and you are uncertain as to when it was made, whether it was made so it was in effect in 1943. It is quite important to know from you what your testimony is as to the custom in 1943, and particularly in October of that year.

A. Yes. Well, I would have to get the record to give you the date. I can't tell you. I know it was since the time I was President in 1939.

Q. (By Mr. Rogers): Mr. Voorhies, are you familiar with the custom in Georgia?

A. Georgia, no.

Q. Are you familiar with the custom in South Carolina?

A. I am not familiar with the custom in any particular state.

Q. Are you familiar with the custom in Colorado? A. No.

Q. Are you familiar with the custom in Louisiana? Or in Mississippi, or Wisconsin?

A. I could not——

Q. North Dakota?

A. You mean as far as the disclaimer?

Q. Yes, just what we are talking about.

A. I am familiar to this extent, that all states that we might ship to or any other grower in any of the states you mention we have our disclaimer on the letterhead, bill head, and the tag, but as to what their interpretation is, I haven't been so unfortunate as to have had experience.

(Testimony of Cyrus F. Voorhies.)

Q. Have you had any claims made against you, sir? A. No, sir.

Q. Never had a claim against you?

A. Just one that I can recall, and I didn't grow the seed.

Q. Did you have a suit filed against you?

A. What?

Q. Did you have a suit filed against you?

A. No, there was no suit, just correspondence.

Q. Did you settle the claim?

A. The party I bought the seed from settled the claim.

Q. That was a grower?

A. Well, he was a grower and wholesaler.

Q. When was that, Mr. Voorhies?

A. That was about twenty years ago.

Q. That would be prior to the change in the disclaimer? A. Oh, yes, twenty years ago.

Q. Now, Mr. Voorhies, you testified you knew what the custom was throughout the United States, and you have since modified that for us. I know who you are and I respect you. Was there any other change made in the custom?

A. Not that I know of.

Q. Besides what you mentioned?

A. Not that I know of. Do you mean a change in the disclaimer?

Q. Yes, in the custom to which you have testified.

A. Not that I know of.

Q. Was there any change made in regard to description? A. Not that I know of.

Q. Mr. Voorhies, I hand you here a letter identi-

(Testimony of Cyrus F. Voorhies.)

fied as Plaintiff's Exhibit 9, which is a letter from the Standard Seed Farms Company to the Barteldes Seed Company, and ask you if this clause, which you say is customary, appears thereon?

A. I believe that is about the same thing we use. I think it is all the same.

Q. Will you read that clause, please?

A. "The Standard Seed Farms Company give no warranty, express or implied, as to the productiveness of any seeds we sell and we will not be in any way responsible for the crop. Our liability in all instances is limited to the purchase price of the seed."

Q. Is there anything said there about description? A. Not a word.

Q. Are you familiar with the attitude of the Department of Agriculture toward disclaimer or responsibility for description of seed sold in interstate commerce? A. No.

Q. Are you familiar as a seed man with the Federal Seed Act of 1939?

A. I have read the Federal Seed Act, I went through it once, there was nothing in there that interested me except the labeling of seed and germination and weed seeds and things like that.

Q. You were president of the Seed Association in 1939 and know that the Act did pass?

A. Yes, I was elected in 1938, served in 1939.

Q. Did you have any discussions as President of the American Seed Association with any representative of the Department of Agriculture in regard to the provisions of it?

A. No. They had a legislative committee with a

(Testimony of Cyrus F. Voorhies.)

chairman and they took up the legislative work for the association.

Q. Did reports come to you——

A. The reports came out at the end of the year. It is published the following year.

Q. Let me ask you again: You had no information in regard to the Federal Seed Act of 1939 as President of the American Seed Trade Association?

A. I don't say I haven't any idea, I have read it and I knew I wasn't doing anything wrong, and I abided by it, and there was nothing that affected me whatsoever, that I could see, I knew what the germination should be, the tolerance allowed, there was no weed seeds allowed, and that is all.

Q. Did the Department of Agriculture have anything to do with the change of custom that you have described? A. You mean the disclaimer?

Q. Yes, sir.

A. No, I don't think so. I don't know, but I don't think they did.

Mr. Rogers: That is all, Mr. Voorhies.

Redirect Examination

By Mr. Harkins:

Q. Mr. Voorhies, I am going to show you Plaintiff's Exhibit 6 here, and call your attention to the small print at the top of the letter and ask you to read that. A. Aloud?

Q. Will you read that aloud, Mr. Voorhies, please?

(Testimony of Cyrus F. Voorhies.)

Mr. Rogers: Now, if the Court please, this is the Plaintiff's letter we are talking about now.

The Court: Pardon me?

Mr. Rogers: This is the Plaintiff's letter we are talking about now.

Mr. Harkins: That is correct.

Mr. Rogers: I think it is immaterial.

The Court: What is the letter?

Mr. Harkins: The letter contains the disclaimer clause at the head of it.

The Court: Is it something in evidence?

Mr. Harkins: Yes, your Honor.

The Court: Well, if it is in evidence, there is no use reading it aloud.

Mr. Harkins: Is that a form of warranty and disclaimer clause that you have used for the seed trade, Mr. Voorhies?

A. Well, the wording here is a little different from our wording.

Q. But you have seen that language?

A. Yes. I have done business with Mr. Barteldes. "The Barteldes Seed Company gives no warranty"——

Mr. Harkins: That is all right, Mr. Voorhies. We won't bother reading it in. That is all, Mr. Voorhies.

Mr. Rogers: Thank you.

Mr. Harkins: Mr. Hamilton, will you take the stand, please?

JAMES WILLIAM HAMILTON
called for the defendant, sworn.

Direct Examination

By Mr. Harkins:

Q. Mr. Hamilton, will you state your occupation, please?

A. My present occupation is Manager of the Seed Division of the Pacific Walnut Company.

Q. And how long have you been engaged in the seed business in any capacity, approximately?

A. Well, I believe it was 1919 or 1920.

Q. Have you been employed by any other concerns in the seed business, Mr. Hamilton?

A. Yes, I was with the old C. C. Morris Company Seed Firm, that was the original firm I started with, then they merged in 1920 with Ferry, and then in 1938 I started the Seed Division with the Pacific Walnut Company.

Q. Those three companies you have referred to, were they California companies?

A. C. C. Morris was a California Company; Ferry, I think I am safe in saying, was a national company—the merger, of course, that took place made them a national company. The Pacific Walnut Company only operates in California.

Q. In your employment by those various companies, Mr. Hamilton, have you engaged in dealing in vegetable seeds, as well as field seed?

A. All my work with C. C. Morris and Ferry and Morris as a genetist was entirely devoted to vegetable seed.

(Testimony of James William Hamilton.)

Q. And are you familiar with a general custom of the seed trade in the State of California relative to disclaimer or non-warranty clauses in the year 1943? A. Yes.

Q. Do you recall what that disclaimer or non-warranty clause provided for? A. In 1943?

The Court: October.

Mr. Harkins: October of 1943.

A. Well, the company gives no express or implied warranty as to productiveness. Their liabilities are limited to the purchase price of the seed only.

Q. And was that disclaimer or non-warranty clause the general custom in the seed trade in the State of California in October of 1943, if you know?

A. That particular disclaimer?

Q. That is right.

A. That had to be accepted in 1943. That was a Government order, because there was many cases tried on the old disclaimer that threw that out. The old disclaimer was the one where there was germination, variety, and so forth and so on, and that didn't hold up in the Federal Court.

Q. And the new clause restricted the liability to the purchase price of the seed?

A. Purchase price of the seed only.

Q. And, Mr. Hamilton, that non-warranty clause that you just spoke of, that was in effect in October of 1943, do you know that met with the approval of the United States Department of Agriculture?

A. It was offered by the Department, therefore I would say yes.

Q. And do you know the reason or purpose of the

(Testimony of James William Hamilton.)

disclaimer or non-warranty clause that was in effect in October, 1943?

A. That disclaimer or non-warranty clause was put there for the sole purpose that no man has control of the content or choromosomes that go into any living matter. We don't have control of cross-pollenization, therefore, we cannot be absolutely positive of our generic strains, so that we do not know what is going to happen in the cellular development of the plant itself.

Another thing, we get into reverts or what is commonly called in the trade as rogues.

Another reason for that in there, the big strike that took place, I believe it was in 1916 or '17, there was a firm back east that had some seed that was mixed maliciously. They didn't know it was mixed until it was shipped out and there was quite a national case made of it, and that is where you may say the real prevalence of the non-warranty clause was born.

Mr. Harkins: That is all.

Cross-Examination

By Mr. Rogers:

Q. Only one question, Mr. Hamilton: I understand that the clause was used to protect the seedsmen from erratic growth in production. By that you don't mean variety of seed?

A. That would not be variety. That would be a condition that we could not control. Variety is something that is established.

(Testimony of James William Hamilton.)

Mr. Rogers: Thank you, sir. I have no further questions.

Mr. Harkins: That is all, your Honor.

The Court: Any rebuttal?

Mr. Rogers: If the Court please, in the pre-trial —we have no rebuttal, your Honor—if the Court please, in the pre-trial discussion your Honor asked if the case of Dutch Valley Growers against the Barteldes Seed Company, if Judge Simms' opinion had been made a matter of record. It wasn't made a matter of record, but I have here his memorandum on questions of law which governed his rulings throughout the case. I do not submit it in evidence, but for your Honor's consideration and for counsel's consideration I would like the liberty of submitting a copy which was prepared in Mr. Pierce's office on Judge Simms' rulings.

Mr. Harkins: If your Honor please, a matter just came to my mind. I wonder if I might call Mr. Barteldes under Rule 42 as an adverse witness, your Honor?

The Court: You may.

ARMIN BARTELDES

called by the defendant under the provisions of Rule 42, having been previously sworn, testified as follows:

Direct Examination

By Mr. Harkins:

Q. Mr. Barteldes, are you familiar with the gen-

(Testimony of Armin Barteldes.)

eral custom in the seed business throughout the United States in October, 1943, relative to disclaimer or non-warranty clauses?

A. I thought I was until this Dutch Valley case came on.

Q. And do you recall at this time what that disclaimer or non-warranty clause provided?

A. Well, there was two of them about that time. I don't know when the change came in. They got me all confused.

Q. Well, I am going to show you Plaintiff's Exhibit Number 6 and call your attention to the disclaimer clause at the head of your letter there, and ask you if that is the disclaimer clause used by the Barteldes Seed Company in October of 1943?

A. Yes, that was.

Mr. Harkins: That is all, Mr. Barteldes.

The Court: Now, both sides rest? What is counsel's pleasure? Do you wish to argue this now or submit it on briefs?

(Discussion as to submitting matter to the court.)

(The matter was ordered submitted on briefs, 20, 20 and 10.)

[Endorsed]: Filed February 9, 1950.

Plaintiff's Exhibit No. 4

For

Customers' Use Only

San Francisco, Calif., Oct. 20, 1943

On arrival seeds Pay to the order of Wells Fargo Bank and Union Trust Co., San Francisco, Calif. $5029.30

Five thousand and twenty nine and 30/100 Dollars Value received and charge the same to account of

STANDARD SEED FARMS CO.

/s/ H. L. JONES,
Mgr.

To

Barteldes Seed Co.,
Denver, Colorado.

50487

[Stamped]: The First National Bank. Paid. Oct. 28, 1943. Collections. Denver, Colo. [Stamped]: Pay to the order of Any Bank or Banker. Your Endorsements Guaranteed. Oct. 22, 1943. [Illegible] Bank & Union Trust Co. San Francisco. 11-16. [Illegible] Dept. A. W. [Illegible]

PLAINTIFF'S EXHIBIT No. 5

Western Union

1943 Oct. 20 P.M. 2 44

FA230 LG—Denver Colo 20 312P

Standard Seed Farms Co—PB. 572

We confirm telephone purchase from you for prompt shipment by Pacific Intermountain truck following onion seed: 20 bags Yellow Globe Danvers 2.50, 10 bags Southport Yellow Globe 2.65, 5 bags Early Yellow Globe 2.65 1 bag Ebenezer 2.75; 5 bags French Breakfast .30; 5 pounds Giant Pascal celery 1.75; all onion 90% or better germination fob Stockton net cash. Airmail invoice and will airmail remittance or draft Colorado National if you prefer.

THE BARTELDES SEED CO.

20 2.50 10 2.65 5 2.65 1 2.75 5 .30 5 1.75 90%.

da 312p B

No. 26943 To....

By K345p To be mail

[Endorsed]: Filed September 22, 1949.

PLAINTIFF'S EXHIBIT No. 6

The Barteldes Seed Company
1521-25 Fifteenth Street, Denver 17, Colorado
P. O. Box 5170 Terminal Annex

October 21, 1943.

Standard Seed Farms Co.
Stockton, California

The Barteldes Seed Co. Gives No Warranty, Express or Implied, as to Purity, Description, Quality, Productiveness or Any Other Matter of Any Seeds, Bulbs or Plants. They Send Out, and Will Not Be in Any Way Responsible for the Crop.

Gentlemen:

We acknowledge receipt of your surplus list of October 18th and confirm having purchased from you over the telephone for prompt shipment all f.o.b. Stockton, California, items as enumerated on the telegram copied below, all to be of high germination, onion seed to germinate 90% or better.

After the telephone conversation we wired you as per copy enclosed reading as follows:

> "We confirm telephone purchase from you for prompt shipment by Pacific Intermountain truck following onion seed: 20 bags Yellow Globe Danvers 2.50; 10 bags Southport Yellow Globe 2.65; 5 bags Early Yellow Globe 2.65; 1 bag Ebenezer 2.75; 5 bags French Breakfast .30; 5 pounds Giant Pascal celery 1.75; all onion 90% or better germination fob Stockton

net cash. Airmail invoice and will airmail remittance or draft Colorado National if you prefer."

We trust you are making prompt shipment by Pacific Intermountain Truck.

We understand that the 1000# of Southport Yellow Globe was grown in Idaho and you will have it shipped by your truck to your place in a few days and forward promptly on receipt of same.

We told you over the phone that if you would send us invoice by air-mail we would remit by air-mail promptly on the items as soon as you have shipped them or, if you prefer, you can make draft on us through the Colorado National Bank of Denver.

Glad we were able to trade with you and if you have other choice quality lots to offer later on you might let us know.

We understand that these stocks are all choice-quality stocks true to type.

Yours very truly,

THE BARTELDES SEED CO.,

By /s/ W. P. STUBBS,

Manager.

WPS:mhn
Enclosure: 2

P.S. Since writing the above we have wired you as per copy of telegram enclosed reading as follows:

"Increase order Early Yellow Globe Onion to 1000 pounds. Confirm."

This makes a total of 1000# of Early Yellow Globe at $2.65 per pound.

/s/ W. P. S.

[Endorsed]: Filed September 22, 1949.

PLAINTIFF'S EXHIBIT No. 7

Standard Seed Farms Company

Stockton, California

Contract Price List

Vegetable Seeds

Season of Oct. 18, 1943

Surplus 1943 Crop

Oct. 18, 1943.

This Agreement, made in duplicate on ....., 19....., by and between the Standard Seed Farms Company, Seed Growers of Stockton, California, hereinafter called the Seller, and..... .....hereinafter called the Purchaser.

Witnesseth: 1. Seller agrees to sell and deliver and purchaser agrees to accept and pay for the varieties of seeds in the amounts, at the prices as set forth below, and subject to the terms and conditions herein provided.

2. Seller agrees to plant, or cause to be planted, during the season of 19....., an acreage of land which will produce, under normal conditions, an amount of seed of the varieties herein named which will be sufficient to enable the Seller to deliver the quantities of the seeds herein contracted for; and the Seller agrees to deliver as soon as possible after harvest, such seeds in good merchantable condition, as herein defined, F.O.B. growing station, containers extra at cost, and not returnable. The term "in good merchantable condition" is defined as seeds properly cleaned for seeding purposes, approximately free from foreign seeds distinguishable by their appearance and of a germination equal to the fair average germination of the crop of the current year.

3. In case of partial or total failure of any or all crops planted for the purpose of producing the varieties of seeds herein named, or, in case of damage to any seed through fire, accident or other

casualty beyond Seller's control, the Seller shall be obligated to deliver, if at all, proportional quantities only.

4. Purchaser shall make payment for seeds delivered, by a trade acceptance due and payable 60 days from date of shipment, or by cash within 30 days from date of shipment, less a discount of 1½%.

If, at any time, the financial condition of the Purchaser becomes unsatisfactory to the Seller, the Purchaser agrees, upon receipt of written notice to that effect, and upon demand of the Seller, to pay for the seeds in advance of shipment, less a cash discount of 1½%, and if such payment is not made within ten (10) days from the receipt of such demand for payment, this agreement shall thereupon be deemed to be breached by the Purchaser.

5. Except as herein otherwise expressly provided, the Seller gives no undertaking or warranty, express or implied, as to description, quality, productiveness, or any other matter of any seeds sold by it and will not be in any way responsible for the crop.

6. Purchaser's claims for shortages of deliveries must be made to Seller immediately on receipt of shipment and all germination tests must be made and reported in writing (including telegram) by Purchaser to Seller within 15 days after receipt of shipment.

In Witness Whereof, the parties have hereunto set their hands on the day and year first above written.

Standard Seed Farms Company ..... The Seller — The Purchaser

By Offers made subject prior sale. By.....

Quantity		Price Per Lb.
	Beet	
.....	Crosby's Egyptian	.....
.....	Crimson Globe	.....
.....	Detroit Dark Red Turnip	.....
.....	Early Blood Turnip	.....
.....	Edmand's Blood Turnip	.....
.....	Extra Early Eclipse	.....
.....	Extra Early Flat Egyptian	.....
.....	Early Wonder	.....
.....	Mangels, Danish Sludstrup	.....
.....	Mangels, Giant Intermediate	.....
.....	Mangels, Giant Long Red	.....
.....	Mangels, Half Sugar Rose	.....
.....	Mangels, Golden Tankard	.....

Quantity		Price Per Lb.
	Carrot	
	Bunching, special	
	Chantenay	$1.40
	Chantenay red core	
	Danvers Half Long	
	Early Scarlet Horn	
	Imperator	$1.40
	Improved Short White	
	Improved Long Orange	
	Nantes, coreless	
	Oxheart	
	Red St. Vallery	
	Yellow Belgian	
	Celery	
	Golden Self-Blanching, Tall	
	Golden Self-Blanching, Dwarf	
	White Plume	
	Giant Pascal—5 lbs.	$1.75
	Utah, green	$1.75
	Celeriac, smooth Prague	
	Endive	
	Broad Leaved—full hearted batavian	
	Curled Leaved—Green	
	Curled Leaved—White	
	Pancalier, pink rib	
	Lettuce	
	Big Boston, w. s.	
	Black Seeded Simpson, b. s.	$1.00
	Denver Market, w. s.	
	Early Curled Simpson, w. s.	
	Grand Rapids, b. s.	
	Hanson, w. s.	
	Hubbard's Market, w. s.	
	Iceberg, w. s.	$1.10
	May King, w. s.	
	New York, w. s. all types	
	New York, Special	
	New York, Number 12	
	New York, Imperial, all types	
	Salamander, b. s.	

Quantity		Price Per Lb.
	Lettuce—(Continued)	
	Prize Head, w. s.	$1.00
	Paris White Cos, w. s.	
	Silesia Early Curled, w. s.	
	White Boston	
	Leek	
	American Flag	
	Mustard	
	Chinese—Broad Leaf	
	Giant Southern Curled	
	Fordhook Fancy	
	Ostrich Plume	
	Onion	
	Ailsa Craig	
	Australian Brown	
	Ebenezer	bot all $3.00
	Early Red Flat	$2.85
	Early Yellow Globe Clarks	bot all $3.00
	Ohio Yellow Globe	
	Prizetaker	
	Red Wethersfield	
	Southport Red Globe	$3.00
	Southport White Globe	
	Southport Yellow Globe	$3.00
	Sweet Spanish, Valencia	
	Sweet Spanish, Riverside	
	Sweet Spanish, White	
	White Lisbon Oregon Danvers	$2.65
	White Portugal	
	White Silver Skin	
	Yellow Flat Danvers	
	Yellow Globe Danvers—bot 2,000 lbs.	$3.00
	Yellow Dutch or Strasburg	
	Early Red Semi globe	$2.85
	Parsley	
	Moss Curled	
	Plain Leaved	
	Turnip Rooted Hamburg	
	Parsnip	
	Half Long Guernsey	
	White Hollow Crown	

Quantity		Price Per Lb.
	Radish	
	China Rose	$0.35
	Crimson Giant	
	Early Scarlet Turnip	
	French Breakfast	$0.35
	Icicle	
	Long Scarlet Short Top	
	Long Brightest Scarlet	
	Scarlet Globe (Vicks)	$0.35
	Sparkler, Half White	
	White Tipped Scarlet Turnip	
	White Vienna	
	Salsify	
	Mammoth Sandwich Island	
	Sweet Peas	
	Eckford Mixed	
	Spencer Mixed—Select	
	Swiss Chard	
	Lucullus	
	White Ribbed, Smooth	

Our time and equipment is devoted exclusively towards developing and improving standard types of vegetable seeds as used by market garden and shippers' trade.

Shipment Rail or Water

[Stamped]: Surplus Crop 1943.

[Endorsed]: Filed September 22, 1949.

PLAINTIFF'S EXHIBIT No. 9

Cable "Stanseed"

Standard Seed Farms Company

of California

Wholesale Growers Garden Seeds

Stockton, Calif.
Oct. 20, 1943.

The Barteldes Seed Co.,
Denver, Colorado.

Gentlemen:

Atten: Mr. Stubbs:

The Standard Seed Farms Co. give no warranty, express or implied, as to the productiveness of any seeds we sell and we will not be in any way responsible for the crop. Our liability in all instances is limited to the purchase price of the seed.

This will confirm our telephone message, also receipt of your wire of yesterday.

Everything seems to be O.K. as regards the agreement but would like to call your attention to the matter of S. P. Yellow Globe, as this was emphasized in our offer over the phone.

This seed is still in Idaho and is waiting for the first cleaning or processing. It is coming down here by truck just as fast as they can get it ready, but they have considerable cleaning to do up there so it may be delayed.

The amount we booked was 1000 lbs. subject the crop turn out, you of course to get anything up to 1000 lbs. Is this agreeing to your views.

The French Breakfast radish is in Washington state and we expect down here anytime for final processing.

The ton of Yellow Globe Danvers was shipped out last night and we have assurance that it should reach Denver in about four days, possibly a little less.

Thanking you for this very nice share of your business, we remain,

Very truly yours,
STANDARD SEED FARMS CO.,

/s/ H. L. JONES,
Mgr.

HLJ.KM.

[Marginal Note]: Mail O.K. 5029[30]

[Endorsed]: Filed September 22, 1949.

DEFENDANT'S EXHIBIT A

[Deft. Stockton #2—shown in pencil on original.]
[Stamped]: 12735.

(For use in connection with Uniform Domestic Order Bill of Lading, adopted for Carriers in Official, Southern, Western and Illinois Classification Territories, March 15, 1922, as amended August 1, 1930, and June 15, 1941.)

This Memorandum is an acknowledgement that a bill of lading has been issued and is not the Original Bill of Lading, nor a copy or duplicate, covering the property named herein, and is intended solely for filing or record.

Shipper's No.....

Independent Freight Lines Agent's No. .....

Received, subject to the classifications and tariffs in effect on the date of the receipt by the carrier of the property described in the Original Bill of Lading, at Stockton, Calif., Oct. 20, 1943, from Standard Seed Farms Co., the property described below, in apparent good order, except as noted (contents and condition of contents of packages unknown), marked, consigned, and destined, as indicated below, which said company (the word company being understood throughout this contract as meaning any person or corporation in possession of the property under the contract) agrees to carry to its usual place of delivery at said destination, if on its own road or its own water line, otherwise to deliver to another carrier on the route to said destination. It is mutually agreed, as to each carrier of all or any of said property over all or any portion of said route to destination, and as to each party at any time interested in all or any of said property, that every service to be performed hereunder shall be subject to all the conditions not prohibited by law, whether printed or written, herein contained, including the conditions on back hereof, which are hereby agreed to by the shipper and accepted for himself and his assigns.

The surrender of this Original Order Bill of Lading properly indorsed shall be required before the delivery of the property. Inspection of property covered by this bill of lading will not be permitted unless provided by law or unless permission is indorsed on this original bill of lading or given in writing by the shipper.

Consigned to Order of Standard Seed Farms Co.,

Destination Denver, State of Colorado.

Notify Barteldes Seed Co., at Denver, State of Colorado.

Route Independent Freight Lines.

No. Packages	Description of Articles	*Weight
20 Bags	Garden Seed (Onion)	2048
	Valued: $5,012.50	
	Bags *16.80*	
	$5,029.30	

[Italics appeared in red crayon on original.]

* If the shipment moves between two ports by a carrier by water, the law requires that the bill of lading shall state whether it is "carrier's or shipper's weight."

Note—Where the rate is dependent on value, shippers are required to state specifically in writing the agreed or declared value of the property.

The agreed or declared value of the property is hereby specifically stated by the shipper to be not exceeding .....

This is to certify that the above articles are properly described by name and are packed and marked and are in proper condition for transportation according to the regulations prescribed by the Interstate Commerce Commission.

Standard Seed Farms Co., Shipper

Per Ascension Olmos.

The fibre boxes used for this shipment conform to the specifications set forth in the box maker's certificate thereon, and all other requirements of Rule 41 of the Consolidated Freight Classification.

Independent Freight Lines, Agent

Per J. V. Sullivan.

[Endorsed]: Filed March 21, 1949.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO RECORD ON APPEAL

I, C. W. Calbreath, Clerk of the District Court of the United States for the Northern District of California, do hereby certify that the foregoing and accompanying documents listed below, are the originals, or certified copies of originals filed in this Court in the above-entitled case, and that they constitute the record on appeal herein as designated by the parties.

Complaint.

Minute order of Dec. 31, 1948.

Answer.

Memorandum, dated May 10, 1949.

Pre-trial order.

Memorandum and order, dated May 10, 1950.

Findings of fact & conclusions of law.

Judgment.

Notice of entry of judgment.

Motion to amend findings & for additional findings to be made.

Motion for a new trial.

Order, dated July 24, 1950.

Notice of appeal.

Designation of record.

Motion to extend time for filing the record on appeal and docketing the action.

Order extending time for filing of record on appeal.

Amended designation of record.

Designation of additional portions of the record requested by appellee.

Plaintiff's exhibits 1 to 9 incl.

Defendant's exhibits A & B.

Two (2) Volumes Reporter's Transcript.

In Witness Whereof, I have hereunto set my hand and the seal of said Court this 9th day of November, 1950.

C. W. CALBREATH,
Clerk.

[Seal] By /s/ C. C. EVENSEN,
Deputy Clerk.

[Endorsed]: No. 12735. United States Court of Appeals for the Ninth Circuit. H. L. Jones, Appellant, vs. Barteldes Seed Company, a Corporation, Appellee. Transcript of Record. Appeal from the United States District Court for the Northern District of California, Northern Division.

Filed November 10, 1950.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

United States Circuit Court of Appeals
Ninth Circuit

No. 12735

THE BARTELDES SEED COMPANY, a Corporation,

Plaintiff and Appellee,

vs.

H. L. JONES, Individually and Doing Business Under the Style and Trade Name of STANDARD SEED FARMS COMPANY,

Defendant and Appellant.

STATEMENT OF POINTS AND ASSIGNMENT OF ERRORS

The Appellant sets forth the following points on which he intends to rely on appeal:

1. That the Court erred in not finding that the law of the State of California governed the performance of the contract which is the subject of this action.

2. That the Court erred in not taking judicial notice of the custom and usage in the seed business not to warrant the description, purity, productiveness or any other matter of the seeds sold, or that seller would not be responsible for the crop.

3. That the Court erred in not finding that the custom and usage in the seed business became an integral part of this contract and negatived any express or implied warranty as to description,

purity, productiveness or any other matter of the seeds sold, and that the seller would not be responsible for the crop.

4. That the Court erred in not finding that the "disclaimer clause" set forth in defendant's surplus list, plaintiff's Exhibit 7, expressly negatived any express or implied warranty in the description, purity, productiveness or any other matter of the seeds sold.

5. That the Court erred in denying the defendant's motion to amend the findings of fact and conclusions of law.

6. That the Court erred in denying defendant's motion for a new trial.

/s/ JAMES I. HARKINS,

/s/ ALBERT E. CRONIN, JR.,
Attorneys for Defendant-
Appellant.

[Endorsed]: Filed Nov. 16, 1950.

[Title of Court of Appeals and Cause.]

DESIGNATION OF RECORD

To the Clerk of the Circuit Court of Appeals of the United States, for the Ninth Circuit:

You are hereby requested to include for the permanent record in the above cause the following:

1. Complaint.
2. Answer.
3. Findings of Fact and Conclusions of Law.
4. Court's Memorandum and Order.
5. Motion to Amend the Findings of Fact.
6. Motion for New Trial.
7. Judgment dated June 14th, 1950.
8. Notice of Appeal.
9. Statement of Points and Assignment of Errors.
10. Testimony of the defendant, H. L. Jones, beginning on page 19, and ending on page 43, of the Transcript, Afternoon Session.
11. Testimony of Cyrus F. Voorhies, beginning on page 43, and ending on page 54, of the Transcript, Afternoon Session.
12. Testimony of Armin Barteldes, beginning on page 58, and ending on page 59, of the Transcript, Afternoon Session.
13. Testimony of W. P. Stubbs, beginning on

page 10, and ending on page 20 of the Transcript, Morning Session.

14. Plaintiff's Exhibits "4," "5," "6" and "7."

15. Defendant's Exhibit "A."

16. This designation of record.

Dated: November 14th, 1950.

/s/ JAMES I. HARKINS,

/s/ ALBERT E. CRONIN, JR.,
Attorneys for Defendant-Appellant.

Affidavits of Service by Mail attached.

[Endorsed]: Filed November 16, 1950.

[Title of Court of Appeals and Cause.]

DESIGNATION OF ADDITIONAL PORTIONS OF THE RECORD REQUESTED BY APPELLEE

To the Clerk of the Circuit Court of Appeals of the United States, for the Ninth Circuit:

Plaintiff and Appellee hereby designates the following additional portions of the record, proceedings and evidence to be included in the permanent record in the above-entitled cause:

1. Minute Order of the United States District Court dated December 31, 1948;

2. Order of Court dated July 24, 1950, amending

Finding No. VII and denying the motion for the amendment of other findings, and denying the motion for new trial;

3. Notice of Entry of Judgment dated June 21, 1950;

4. Memorandum and Order of United States District Court dated May 10, 1950;

5. All of the testimony of W. P. Stubbs, being the whole of the deposition of said W. P. Stubbs admitted or read in evidence;

6. Testimony of Armin Barteldes, page 2, of the Reporter's Transcript;

7. Testimony of James William Hamilton, beginning on page 54, and ending on page 58, of the Reporter's Transcript;

8. Plaintiff's Exhibit Number 9;

9. This designation of additional portions of the record.

Dated this 27th day of November, 1950.

Respectfully submitted,

MULL & PIERCE and
KENAZ HUFFMAN, ESQ.,

By /s/ F. R. PIERCE,

Attorneys for Plaintiff and Appellee.

Affidavit of Service by Mail attached.

[Endorsed]: Filed November 28, 1950.

No. 12,735

United States Court of Appeals

For the Ninth Circuit

H. L. JONES, individually and doing business under the style and trade name of STANDARD SEED FARMS COMPANY,

Appellant,

vs.

THE BARTELDES SEED COMPANY (a corporation),

Appellee.

APPELLANT'S OPENING BRIEF.

JAMES I. HARKINS,
ALBERT E. CRONIN, JR.,
300 American Trust Company Building, Stockton 5, California,
Attorneys for Appellant.

Subject Index

Table of Authorities Cited

Statutes and Codes

Texts

No. 12,735

United States Court of Appeals
For the Ninth Circuit

H. L. JONES, individually and doing business under the style and trade name of STANDARD SEED FARMS COMPANY,

Appellant,

vs.

THE BARTELDES SEED COMPANY (a corporation),

Appellee.

APPELLANT'S OPENING BRIEF.

JURISDICTION.

The basis upon which it is contended that the United States District Court, Northern District of California, Northern Division, had jurisdiction over the subject matter in the present Court is because of the diversity of citizenship of the plaintiff and the defendant, as shown in paragraph I of the Complaint, page 3 of the transcript of record; and that the subject matter involved is over the sum of Three Thousand ($3,000) Dollars, exclusive of interest and costs, as shown in the prayer of the original com-

plaint, beginning on page 8 of the transcript of record. Title 28—Section 1332 U.S.C.A.

The basis upon which it is contended that the United States Court of Appeals for the Ninth Circuit has jurisdiction in the appeal of this matter is that final judgment was entered in the District Court of the United States in and for the Northern District of California, Northern Division, as shown on page 40 of the transcript of record; and that the procedure for appeal to the Ninth Circuit Court of Appeals has been followed by the parties. Title 28—Section 1291 U.S.C.A.

SPECIFICATIONS OF ERROR.

1. The Court erred in not finding that the law of the State of California governed the performance of the contract which is the subject of this action.

2. The Court erred in not finding that the disclaimer clause set forth in plaintiff's exhibit No. BII negatived any expressed or implied warranty as to the description of the seed sold.

3. The Court erred in not finding that custom and usage in the seed business became an integral part of the contract of sale and negatived any expressed or implied warranty as to the description of the seeds sold.

4. The Court erred in denying defendant's motion to amend the Findings of Fact and Conclusions of Law.

SUMMARY OF FACTS.

This is an action for breach of warranty in the sale of onion seeds between two established seed houses who had done business over a period of thirty (30) years, and both of whom used and knew of standard seedmen's disclaimer not to warrant the variety of seeds sold.

The reason for this refusal to warrant seeds is due to the fact that onion seeds are not distinguishable as to variety and type from each other until they have matured into the grown onion.

The Appellant in his course of business, as a grower and seller of seeds, on or about the 18th day of October, 1943, sent to the Appellee, and others in the seed business, a surplus list of seeds that he had in stock and were available for sale. The surplus list had plainly printed on it the refusal to warrant the seeds sold.

On October 20, 1943, the Appellee through Mr. Stubbs, its manager, from its office in Denver, Colorado, telephoned the Appellant in Stockton, California and offered to buy two thousand (2,000) pounds of Yellow Globe Danver onion seed at Two and 50/100 ($2.50) Dollars per pound; said seed being in the surplus list at Three and 00/100 ($3.00) Dollars per pound. The Appellant accepted the offer and was instructed to ship the seeds via Pacific Intermountain Truck to the Appellee in Denver, Colorado. The terms of the sale were "net cash, f.o.b. Stockton." Other than the disclaimer of warranty in the

surplus list no mention was made of warranty or refusal to warrant.

Subsequent to the telephone conversation Appellee confirmed the seed purchase and terms of the sale by telegram and by letter.

On the 20th of October, 1943, the seeds were shipped according to instructions via Pacific Intermountain Truck to the Appellee in Denver, Colorado. To secure payment of the purchase price with the seed was sent a sight draft bill of lading drawn to the order of Appellant. The draft was honored by the Appellee.

Subsequent to the receipt of the seeds, the seeds were relabeled by the Appellee and one thousand (1,000) pounds of the Yellow Globe Danvers were sold to the Dutch Valley Growers of Illinois.

The Dutch Valley Growers planted the seed and when the seed matured into an onion it did not have the characteristics of the Yellow Globe Danver variety. The Dutch Valley Growers brought suit against the Appellee for breach of warranty, and after a jury trial of one week they recovered judgment in the amount of $4,684.00 and $322.26 as costs. The Appellee now brings this action for $5,006.26 as rendered against it in the prior action and for $8,402.59 which they allege as reasonable attorney's fees, and costs to defend this prior action.

THE LAW GOVERNING THE PERFORMANCE, BREACH AND MEASURE OF DAMAGES INVOLVED IN THIS CONTRACT.

Before we can determine the rights of the respective parties under the contract as above set forth we must first determine the law of which State we shall apply to the performance, breach of performance and rights to damages.

The California law on this matter is consistent with the Restatement of Conflict of Laws, A.L.I.

Section 1646 of the Civil Code of California provides that a contract is to be interpreted according to the law and the usage of the place where it is to be performed; or if it does not indicate a place of performance, according to the law and usage of the place where it is made.

The Restatement of Conflict of Laws, A.L.I., provides as follows in regard to the performance of contracts:

"Section 355. Place of Performance.

The place of performance is the State where, either by specific provision or by interpretation of the language of the promise, the promise is to be performed."

"Section 358. Law Governing Performance.

The duty for the performance of which a party to a contract is bound will be discharged by compliance with the law of the place of performance of the promise with respect to:

(a) the manner of performance;

(b) the time and locality of performance;

(c) the person or persons by whom or to whom performance shall be made or rendered;

(d) the sufficiency of performance;

(e) excuse for non-performance."

"Section 361. What Amounts to Performance.

The law of the place of performance determines the details of the manner of performing the duty imposed by the contract."

"Section 370. Law Determining Breach of Performance.

The law of the place of performance determines whether a breach has occurred."

"Section 372. Right to Damages and Measure of Damages.

The law of the place of performance determines the right to damages for a breach of a contract and the measure of the damages."

The Colorado and the California annotations to the Restatement of the Law of Conflict of Laws support the principles above set forth.

The following authorities are cited in support of the proposition that the law of the place of performance governs the method and manner of performance:

Bertonneau v. S.P. Co. (1917) 17 C.A. 439; 120 P. 53;

Flittner v. Equitable Life Assur. Soc., 30 C.A. 209; 157 P. 630;

Pray v. Trower Lumber Co. (1940) 101 C.A. 482; 281 P. 1036;
Blair v. N.Y. Life Co. (1940) 40 C.A. (2d) 494; 104 Pac. (2d) 1075;
Hayter v. Fulmor (1944) 66 C.A. (2d) 554; 152 Pac. (2d) 746;
Monarch Brewing Co. v. Meyer Mfg. Co., 130 F. (2d) 582;
Tuller v. Arnold, 93 Cal. 166; 28 P. 863.

The alleged failure of performance to deliver Yellow Globe Danver onion seed ordered by the Appellee in this case occurred in California when the seed was delivered according to instructions to the Pacific Intermountain Truck Lines to be carried to the Appellee in Denver, Colorado. Nothing further remained for the Appellant to do under the terms of the contract, and nothing remained for the Appellee to do other than to pay the purchase price.

DID THE FACT THAT THE GOODS WERE SHIPPED TO THE APPELLEE WITH A SHIPPER'S ORDER BILL OF LADING CHANGE THE PLACE OF PERFORMANCE?

This question is answered in the negative in clear unequivocal language by the Uniform Sales Act as incorporated in Section 1740(2) of the Civil Code of the State of California.

Prior to the adoption of the Uniform Sales Act there was a conflict of authorities in the United States on the question of whether or not title remained in the seller until the goods arrived at their destination. 60

A.L.R. 677; 101 A.L.R. 298. The California Courts in the case of *Puritas Coffee and Tea Company v. De Martini,* 58 Cal. App. 628, 206 Pacific 96, in 1922 prior to the adoption of the Uniform Sales Act held that the title remained in the seller until the goods arrived at their destination. However, the enactment of the Sales Act in California overruled this Court decision. This Court's attention is called to the clearness of the act,

> "1740. Reservation of right of possession or property when goods are shipped.
>
> (2) Order of Seller. Where goods are shipped, and by the bill of lading the goods are deliverable to the seller or his agent, or to the order of the seller or his agent, the seller thereby reserves the property in the goods. But if, except for the form of the bill of lading, the property would have passed to the buyer on shipment of the goods, the seller's property in the goods shall be deemed to be only for the purpose of securing performance by the buyer of his obligations under the contract."

and the interpretation placed on it in the case of *Alderman Brothers v. Westinghouse Air Brake Co.* (1918) 92 Conn. 419, 103 Atl. 267, 60 A.L.R. 691.

> "One question raised was what effect should be given under the Sales Act to the fact that the bill of lading was drawn to the seller's order endorsed in blank and forwarded to the seller's agent at the place of destination with a sight draft attached. The Court, in holding the title passed at the time of the contract of sale and that the effect of drawing the bill of lading to

> the seller's order was merely to reserve the jus disponendi, said, 'It makes no difference to buyer who has agreed to pay the freight whether a sight draft is presented to him attached to a bill of lading drawn to his own order or to a bill of lading drawn to the order of the seller and endorsed in blank. In either case he must pay his draft in order to get possession of the goods, and in either case his rights on paying the draft are the same. The risk of loss unquestionably passes to the buyer in the former case as soon as the goods are delivered to the carrier. Section 22 of the Sales Act provides it shall pass to the buyer at the same time in the latter case, provided the seller's purpose in drawing the bill of lading to his own order was merely to secure payment of the draft.''

The testimony of the Appellant on page 81 of the transcript of record in answer to the question why a shipper's bill of lading was used stated that this method was used to secure the payment of the purchase price. In plaintiff's exhibits V and VI the Appellee agreed to pay the purchase price by air mail or on receipt of the invoice and suggested that the Appellant ship the goods and draft on Colorado National Bank of Denver, should he so prefer. In analyzing these exhibits we can see the thoughts of the parties that this purchase was to be a cash transaction, and that the Appellant used this method to secure payment of the purchase price. Therefore applying the facts in the case to the law as incorporated in Section 1740, paragraph 2, it is the Appellant's

contention that the sending of the seller's order bill of lading with a sight draft attached was done solely for security purposes, and that the title passed when seed was delivered f.o.b. Stockton, California, to the carrier designated by the Appellee and that Stockton was the place of performance.

THE NEXT QUESTION THEN ARISES DID THE FACT THAT THE GOODS WERE SHIPPED F.O.B. HAVE ANY EFFECT ON THE PLACE OF PERFORMANCE?

This question is answered in the affirmative by our California Court. The general rule of law applicable to this type of shipment is that if the agreement is to sell goods f.o.b. at a designated place, such place will ordinarily be regarded as the place of delivery; but the effect of f.o.b. depends upon the connection in which it is used, and if used in connection with words fixing the price only it will not be construed as fixing the place of delivery.

Johnson v. Banta (1948) 87 Cal. App. 907, 198 Pac. (2d) 100;

Gallo v. Boyle Manufacturing Company, 35 Cal. App. 168, 169 Pac. 401.

Observing plaintiff's exhibits V, VI and VII, it is very obvious that all the seeds that were offered for sale and purchased were listed at a certain price per pound. All purchases regardless of quantity were to be made f.o.b. Stockton, California. In the instant case the terms of the contract as shown in the surplus list

and the telegram confirming the sale and in the letter confirming the sale were two thousand (2,000) pounds of Yellow Globe Danver onion seed at Two and 50/100 ($2.50) Dollars per pound, along with various other seeds as shown in the exhibits, all shipments to be made f.o.b. Stockton, California.

From these facts the logical assumption to be drawn was that the seeds were sold by the pound and that the term f.o.b. in no way affected the purchase price, and hence the conclusion that the place of delivery and performance of the contract in this instant case was in Stockton, California, when the goods were delivered to the carrier designated by the Appellee.

WHAT TYPE OF SALE WAS INVOLVED?

This was a sale of goods by description. This Court will note in plaintiff's exhibits V, VI and VII that the onion seed which is the subject of this action was described as Yellow Globe Danvers onion seed, which is a distinctive kind of onion seed, and is recognized as such in the seed trade.

The deposition of Mr. W. P. Stubbs on page 49 of the record shows that he used the term "Yellow Globe Danvers Onion Seed" in his offer of purchase, and that the Appellant accepted his offer.

The logical effect of a sale of goods by description is brought forth in the California Civil Code, in Section 1734, which states: "that where there is a con-

tract of sale or a sale of goods by description there is an implied warranty that the goods shall correspond with the description. Therefore in this case there was an implied warranty that the onion seed sold to the Appellee would answer the description of Yellow Globe Danvers.

WHAT EFFECT DID THE NON-WARRANTY CLAUSE IN THE SURPLUS LIST HAVE ON THE IMPLIED WARRANTY?

The non-warranty (or disclaimer) as shown in paragraph V of the plaintiff's exhibit VII on page 144, negatived any implied warranty that the onion sale would answer the description of Yellow Globe Danvers. In order to bring before the Court the reason that the non-warranty clause as contained in plaintiff's exhibit VII negatived any implied warranty we feel that it is worth while to set forth the seed law as developed in the United States.

The leading case on the subject of disclaimer of warranty which contains an excellent statement of the reasons for the validity of a disclaimer of warranty is *Ross v. Northrup* (1914) 156 Wis. 327, 144 N.W. 1124. In this case the catalog of a seed company contained a printed disclaimer of any warranty, and the shipping tag also had a similar statement, as had the invoice of the shipment, which contained the additional statement that if the purchaser would not accept the goods on those terms, they might be returned and the money would be refunded, and it ap-

peared that the buyer had no knowledge or information of these disclaimers of warranty and that such a disclaimer was not printed upon the package in which the seed was delivered to him. In holding that he was chargeable with knowledge of the fact that the seller refused to warrant the seeds sold the Court said:

> "The defendant having the right to sell without warranty, it seems clear that it did all that could in reason be required of it to advise the purchaser of the condition upon which the seed was sold. Of course it is easy to imagine other things which it might have done which would be better calculated to give notice, but if those things had been done, and had proved inefficacious, still other things might be suggested which would surely acquaint Morton with the conditions of sale. The business was transacted by mail. Where the book from which the order was given, the shipping tag, and the invoice, all stated these conditions, it would seem to be unreasonable to hold that any blame attached to the defendant if Morton failed to observe all of these things. . . Mr. Morton could not close his eyes to the information that was literally staring him in the face and then hold the defendant liable because he did so. In matters of contract one must observe what he has reasonable means of knowing. The law for the protection of persons even against fraud will not be extended to those who 'having the means in their own hands neglect to protect themselves . . . The law requires men, in their dealings with each other, to exercise proper vigilance, and apply their attention to those particulars which may

be supposed to be within reach of their observation and judgment and not close their eyes to the means of information which are accessible to them.' Mamlock v. Fairbanks (1879) 46 Wis. 415, 417, 418, 1 N.W. 167, 169, 32 Am. Rep. 716; Bostwick v. Mutual L. Ins. Co. (1902) 116 Wis. 392, 400, 89 N.W. 538, 92 N.W. 246, 67 L.R.A. 705. And where a purchaser is put upon inquiry as to the quality of the thing offered for sale, he is bound to know what is discoverable in regard thereto by the exercise of ordinary care, and he cannot 'close his eyes to defects which are before him or to information which is at hand.' Warner v. Benjamin (1895) 89 Wis. 290, 62 N.W. 179. In the absence of fraud 'a man cannot relieve himself from the obligation of a written agreement by saying he did not read it when he signed it, or did not know what it contained.' Deering v. Hoeft (1901) 111 Wis. 339 (87 N.W. 298), and cases cited on page 343; Steffen v. Supreme Assembly of Defenders (1907) 130 Wis. 485, 487, 110 N.W. 401."

The *Ross* case was followed in California in the *Miller v. Germain Seed & Plant Co.* (1924) 193 Cal. 62, 222 P. 817, 32 A.L.R. 1215. In that case the buyer ordered by letter from the seller, who was in the business of furnishing seed for agricultural purposes, a certain kind of celery seed. It was conceded by the Court that from a transaction of this character the law implies a contract of warranty, and the question in the case was whether or not such a warranty was negatived by a disclaimer existing in the form of a custom not in any way to warrant seed. Holding that

the case should have been submitted to the jury upon an instruction in effect that the warranty relied upon was negatived if the jury found as a fact that there was a custom in the trade not to warrant the description, quality, or productiveness of seeds bought or sold, and that this custom was a well-established one and well known both to those buying and selling seed, the Court expressly declared that this custom or usage would control the transaction in question even though the custom was not known to the particular buyer. The Court said:

> "The rule seems to be uniform that a party to a contract may be bound by a custom not inconsistent with the terms of the contract, even though he is ignorant of the custom, if the custom is of such general and universal application that he may be conclusively presumed to know the custom."

This case was followed by *Lehner v. Germain Seed & Plant Co.* (1924) 192 Cal. 782, 222 P. 834.

We call the Court's attention to the fact that the California Supreme Court in the *Miller v. Germain Seed & Plant Co.* quoted extensively from the *Ross v. Northrup, K. & Co.,* supra, and followed its entire reasoning as appears on pages 67 and 68 of the *Miller* case.

The next California case concerning the sale of seeds was the *William A. Davis Co. v. The Bertrand Seed Co.* (1928) 94 Cal. App. 281, 271 P. 123. That case held that a disclaimer of an intent to warrant

the description, quality or productiveness of seeds, sold by one wholesale dealer in seeds to another, in a printed statement preceding the typewritten portion of a letter embodying an offer to sell, and in every letter received by the buyer throughout the correspondence, was binding on the buyer, who was aware of the contents, purpose, and intent of the printed statement, and relied on a claim of fraud and breach of honor and fair play in the seller's representation that it exercised great care to have all seeds pure and reliable, rather than on the disclaimer as such. The Court based its holding on the rule that,

> ". . . the binding effect of a statement printed upon a letterhead or some other paper delivered to the acceptor of an offer depends on whether the person receiving it should understand, as a reasonable man, that it contains the terms of the contract, which must be read at his peril and regarded as part of the proposed agreement."

The Court further held in regard to the language used concerning the sale, the following:

> "Furthermore, as regards respondent's claim that in face of the non warranty clause the following language is sufficient to show an intent on the part of the seller to give an express warranty as to variety and purity: 'The stock offered was all choice seedsmen stock and double milled.'
>
> As shown at Page 103, 93 Cal. (222 P. 833), the dissenting opinion in the case of Miller v. Germain Seed & Plant Co., supra, statements of much stronger import were contained in the seller's printed catalogue and were evidently not

considered by the court of sufficient import to nullify the effect of a mere custom. And in the case at bar the language relied upon should be and can be construed in a reasonable sense which will preserve and not do violence to the plain meaning of the express language of the non-warranty clause; and be construed simply in connection with the statement touching care in the selection and expressive merely of an opinion in good faith as to the general merits of the defendant's stock in trade."

The above *Bertrand* case clears any doubt that might arise concerning a warranty when the Appellant agreed that these stocks were all choice quality stocks, true to type, and that he was merely stating his opinion in good faith as to the description of the stock, and was in no way warranting that the stock would answer the description of the seed purchased by the Appellee.

The *Bertrand* case was followed in California in the case of *Sutter v. The Associated Seed Growers* (1939) 31 Cal. App. (2d) 543 and 88 P. (2d) 144, which held that the statutory implied warranty of fitness does not apply to a sale where the seller expressly disclaims liability for the quality of the thing sold.

The California case above quoted should uphold the theory that a seedsman may validly disclaim any responsibility as to description, quality or productiveness, or any matter of the seed sold and will not be in any way responsible for the crop and these cases

coincide with what is now considered the majority opinion in this type of sale throughout the United States. The validity of the disclaimer clause has been upheld in the following cases: The *Leonard Seed Company v. Crary Canning Company* (1911) 147 Wis. 166, 132 N.W. 902. The disclaimer clause in the contract was held valid as to variety.

In *Kibbe v. Woodruff* (1920) 94 Conn. 443, 109 Atl. 169, the disclaimer on an order placed was held valid as to variety of seed sold.

In *Calhoun v. Brinker* (1907) 17 Ohio Decisions, Page 705, the disclaimer on a packet of seeds was held valid as to the variety of the seeds.

In *Seattle Seed Company v. Fujimori* (1914) 79 Wash. 123, 139 P. 866, the disclaimer on the identification slip placed inside the package of seed was held valid as to variety.

In *Manglesdorf Seed Company v. Busby* (1926) 118 Okla. 255, 247 P. 410, a disclaimer orally communicated to the buyer was held valid.

In *Larson v. Inland Seed Co.* (1927) 143 Wash. 557, 255 P. 919, the disclaimer on the packet of seeds was held valid.

In *Hoover v. Utah Nursery Co.* (1932) 79 Utah 12, 7 P. (2d) 270, the disclaimer on the packet was held valid.

In *Blizzard Brothers v. Growers Canning Company* (1911) 152 Iowa 257, 132 N.W. 66, the non-warranty on the package of the seed was held valid.

In *Lombrazo v. Woodruff* (1931) 256 N.Y. 92, 175 N.E. 525, the disclaimer in the contract was held valid.

In *Landreth Seed Co. v. Kerlec Seed Co.* (1930) La., 126 So. 460, the disclaimer in the invoice and the catalogue was held valid.

In *Petterson v. Parrott* (1930) Maine, 152 Atlantic 313, the disclaimer on the order sheet was held valid.

In *Kennedy v. The Cornhusker Hybrid Co.* (1945) Neb., 19 N.W (2d) 51, 160 A.L.R. 351, the disclaimer on the invoice and tag were held valid.

In *J. S. Elder Grocery Co. v. Appelgate* (1922) Ark., 237 S.W. 92, the disclaimer in an advertisement was held to be valid.

In *Belt Seed Co. v. Mitchelhill Seed Co.* (1941) 236 Mo. App. 142, 153 S.W. (2d) 106, the disclaimer in the seller's confirmation of sale was held to be valid.

In the *Eastern Seed Co. v. Pyle* (1946) Texas, 198 S.W. (2d) 562, the disclaimer clause contained in the contract was held valid.

In conclusion it is Appellant's contention that the disclaimer or non-warranty clause is contained in the surplus list, Plaintiff's Exhibit 7, on page 114 of the transcript of record negatived any implied warranty which the law would impose in a sale of goods by description.

WHAT EFFECT WOULD THE SALES ACT HAVE UPON THE VALIDITY OF THE NON-WARRANTY CLAUSE?

The Uniform Sales Act would not effect the validity of the non-warranty clause.

Although there are no California cases on the validity of the disclaimer clause subsequent to the *Bertrand Seed* case, supra, other jurisdictions which have adopted the Uniform Sales Act have reconciled the two.

In the case of *Lombrazo v. Woodruff* (1931) 256 N.Y. 92, 175 N.E. 525, 75 A.L.R. 1017, it was held that the non-conformity of onion sets to the description under which they were sold gave the buyer no cause of action for damages against the seller where the contract of sale (governed by the provision of the Uniform Sales Act which makes conformity of goods to the description under which sold an implied warranty) contained a disclaimer warranty clause as follows: "We give no warranty, express or implied, as to description, quality, productiveness, or any other matter of any seeds sent out, and will be in no way responsible for the crop." The Court remarked that the word "warranty" as used in the contract of sale had reference to those warranties defined in the Uniform Sales Act, unless it was otherwise defined or restricted; that the parties in the disclaimer of warranty clause exercised a right and privilege expressly reserved to them by a provision of the personal property law, declaring,

> "Where any right, duty or liability would arise under a contract to sell or a sale by implica-

tion of law it may be negatived or varied by express agreement, or by the course of dealing between the parties or by custom, if the custom be such as to bind both parties to the contract or the sale.

A disclaimer by a seller of seeds by a description of any implied warranty of the conformity of the seeds to the description is not contrary to public policy."

In upholding the non-warranty clause the Court in *Hoover v. The Utah Nursery Co.* (1932) 79 Utah, page 12, 7 P. (2d) 270, remarked that,

"Although the Uniform Sales Act in force in this jurisdiction provides that, where there is a sale of goods by description, there is an implied warranty that the goods shall correspond with the description, this same Act further provides that when any right, duty, or liability shall arise under a sale by implication of law, it may be negatived or varied by express agreement or by course of dealing between the parties, or by custom, if the custom be such as to bind both parties."

In the case of *Kennedy v. The Cornhusker Hybrid Co.* (1945) 19 S.W. (2d) 51, 160 A.L.R. 351, the Court in upholding the disclaimer clause and reconciling its validity with the Sales Act stated:

"The Nebraska Uniform Sales Act . . . clearly recognizes the almost uniform rule that one who sells personal property may effectually disclaim as to any warranty in connection with the sale.

Section 69-471, R.S. 1943, provides:

'Where any right, duty, or liability would arise under a contract to sell or a sale by implication of law it may be negatived or varied by express agreement or by the course of dealing between the parties, or by custom, if the custom be such as to bind both parties to the contract or the sale.'

It is stated in 55 Corpus Juris, Section 707, page 730:

'The seller's refusal to warrant is not repugnant to or voided by, the provisions of the Uniform Sales Act relative to implication of warranty,' and, 'when the seller has expressly refused to warrant the property in certain particulars there can be no implied warranty of a character covering those particulars . . .'

The statement is made in 55 Corpus Juris, Sec. 698, Page 710:

'The seller of property may by disclaimer of warranty refuse to warrant the property sold unless a disclaimer of warranty is contrary to the statutory provisions; . . .' And, 'any disclaimer of warranty so expressed that its existence and nature is understood by the parties to the sale as constituting a term of the bargain operates thus: as for instance, where the buyer is given to understand that he must take the property, if at all, on his own judgment, and a provision of non-warranty may be operative when used in letterheads or containers in which the subject matter of the sale is sold, on bills for the price of goods, in notes for the purchase price, or in catalogues'."

The Court will note that in the adoption of the Uniform Sales Act that the provisions contained as to non-warranty in the cases above cited are identical with Section 1791 of the Civil Code of the State of California.

The Appellant submits to the Court that when he sent the surplus list to the Appellee with the standard seedmen's disclaimer clause clearly printed on it that he was inviting offers for the seeds that he had on hand and were for sale with the condition that he would not warrant the description of the seeds and that this non-warranty was not repugnant to or voided by the Uniform Sales Act or public policy.

WHAT EFFECT WOULD CUSTOM AND USAGE HAVE ON THIS CONTRACT?

The custom and usage became an integral part of the contract. The California Courts in the case of *Miller v. Germain Seed & Plant Co.* in 193 Cal., at page 67, in quoting from the case of *Ross v. Northrup,* 156 Wis. 327, 144 N.W. 1124 (1914) said:

> "It is not the law that ignorance of a general trade custom relieves the party from the effect of it. If there was a general custom among seedsmen such as was found, Morton as a retail dealer in seeds was bound to know of it.
>
> 'The object of proving a general custom is not to contradict or change a contract made between the parties, but to interpret it to the court and jury as it was understood between the parties at

the time it was made and this evidence of a general custom, when it does not contradict or change the express terms of the written contract is admitted for the purpose of showing what the real contract between the parties was, and when it is clearly proven the parties are supposed to have contracted with reference to such custom, unless such custom changes the express terms of the written contract.'

A uniform trade custom is readily accepted by courts to define what is ambiguous or is left indeterminate in a contract. Where both parties have knowledge of the custom, or are so situated that such knowledge may be presumed, for the reason that the majority of such transactions are had in view of the custom and the agreement on which the minds of the parties actually met will thereby be carried into effect. Where the custom is proved to be known to both it may even add terms to the contract. Where the custom is general it will be presumed to have entered into the contract and one may be bound thereby although ignorant unless the other party be shown to have knowledge of his ignorance."

The California Courts in following the *Miller v. Germain Seed & Plant Co.* case, supra, have held that a party to a contract may be bound by a custom not inconsistent with the terms of the contract even though he is ignorant of the custom if the custom is of such general and universal application that he may be presumed to know of it.

Pastorino v. Greene Brothers (1949) 90 Cal. App. (2d) 481, and

Newcomb v. Sainte Claire Realty Company, 55 Cal. App. (2d) 437, and in 130 P. (2d) 793.

The Appellant in this case submits to the Court that the usage and custom in the seed business not to warrant the description of seeds was an integral part of this contract of sale, not only because of the disclaimer clause as printed in the surplus list, but also because of usage and custom in the seed business not to warrant the seeds sold. That the Appellee had knowledge of this custom and usage; Appellant has shown in Plaintiff's Exhibit 6, Page 111 of the transcript of record that on the letterhead of the Barteldes Seed Company is printed the standard seedmen's disclaimer clause as used by the Barteldes Seed Company.

FINDINGS OF FACT.

In conclusion the Appellant respectfully submits to the Court that the contract in this case was made in the State of California when the offer of sale was accepted by the Appellant; was performed in the State of California when the Appellant delivered the goods to the carrier at Stockton, California, and that the non-warranty clause in the surplus list negatived any implied warranty that might arise in the sale of goods by description and that the Appellee knew of and used the non-warranty clause and that in the formation of this contract the fact that the Appellant did not warrant the description or variety of the seeds sold became an integral part of the sale.

The Appellant contends that the Court erred in denying the defendant's motion to amend the findings of fact and that additional findings of fact be made. Referring the Court's attention to Paragraph 3 of the Findings of Fact, the Appellant contends that he accepted the seed offer and agreed to sell the plaintiff said quantity of onion seeds of said variety known as "Yellow Globe Danvers" at and for said purchase price f.o.b. Stockton, California and to deliver the same f.o.b. Stockton, California, that said agreement was confirmed in writing; . . . that on or about October 28, 1943 defendant delivered to plaintiff f.o.b. Stockton, California 2005 pounds of onion seeds . . . The statement of fact as therein set forth is inconsistent with the memorandum and order of the Court as shown on page 23 of the transcript of record and Plaintiff's Exhibits 5 and 6 in which it was stated that the onion seed purchased was to be delivered f.o.b. Stockton, California and did not state the goods were to be delivered to the plaintiff at Denver, Colorado.

The Appellant contends that the Court erred in not including as a Finding of Fact that a non-warranty clause was contained in the surplus list as shown in the surplus list, Plaintiff's Exhibit 7, on Page 114 of the transcript of record.

Appellant contends that the Court erred in not finding that the manner of shipping the seeds with a seller's order bill of lading with sight draft attached was done for the sole reason of security for the pur-

chase price. This is substantiated in the testimony of Hugh L. Jones on Page 81 of the transcript of record.

It is contended by the Appellant that the Court erred in not finding that the contract was made in Stockton, California and was performed in Stockton, California. That the contract was made in California is shown in the Memorandum of Order of the District Court set forth in page 23 of the transcript of record, which states that the offer to purchase 2000 pounds of seed at $2.50 a pound was accepted by the defendant in California, and that it was agreed that this seed would be shipped by truck f.o.b. Stockton, California. The fact that the contract was performed in California is also confirmed by the testimony of Hugh L. Jones that the freight was delivered as shown on page 77 of the transcript of record.

Dated, Stockton, California,
February 21, 1951.

Respectfully submitted,
JAMES I. HARKINS,
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Attorneys for Appellant.

No. 12,735

United States Court of Appeals

For the Ninth Circuit

H. L. JONES, individually and doing business under the style and trade name of STANDARD SEED FARMS COMPANY,

Appellant,

vs.

THE BARTELDES SEED COMPANY (a corporation),

Appellee.

BRIEF FOR APPELLEE.

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No. 12,735

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Appellant,

vs.

THE BARTELDES SEED COMPANY (a corporation),

Appellee.

BRIEF FOR APPELLEE.

INTRODUCTION.

The question involved in this appeal is the following:

Where as a part of an oral contract between a seller and a buyer of seed it is expressly stipulated and agreed that the seed shall be Yellow Globe Danvers onion seed "true to type" and where the court finds upon the evidence of the seller's own expert that there is no general custom of the trade disclaiming liability for failure to deliver the type agreed to be delivered, is the seller relieved from liability for failure to deliver seed of the type contracted for and from the consequential damages to the buyer if

(a) there was a printed paragraph in the body of a printed contract not used by the parties or referred to in any way but sent out with a surplus list disclaiming a warranty of description "except as herein otherwise expressly provided"?

(b) After the contract was completely executed the seller writes a letter containing on the letterhead a printed disclaimer of productiveness but not of description?

Appellant has not stated all of the facts; the facts most material to the case have been carefully omitted. No facts have been supported by references to the record—this in direct violation of subdivision 2(f) of rule 20 of this court requiring statements of fact in the argument to be supported "with a reference to the pages of the record".

So that the court may understand the issues the following is a supplementary statement of the facts.

STATEMENT OF FACTS.

Appellant Jones in the course of his business as a seed grower and seller sent a "surplus list", a statement of quantities and varieties of seed for sale, to Appellee Barteldes Seed Co. Included in this list was a quantity of "Yellow Globe Danvers" onion seed. (Pltfs. Exhibit 7, R. pp. 113, 114.)

W. P. Stubbs, manager of the Denver branch of Appellee, having received the list, telephoned Appellant Oct. 19 or Oct. 20, 1943 and an oral contract was en-

tered into during the telephone conversation. (R. p. 49.)

By the terms of this oral agreement Appellant agreed to sell and Appellee agreed to purchase 2,000 pounds of Yellow Globe Danvers Onion Seed at $2.50 per pound. The following was a part of the conversation and contract. Stubbs testified:

> "I told him (Jones) at the time that we only wanted first-class quality stocks of high germination and *true to type,* and he (Jones) assured me that the stocks were first class quality and of high germination."

Nothing was said in this conversation about any limitation of liability or non-warranty or about the possibility of the seed not being Yellow Globe Danvers. (R. p. 50.)

This sale was confirmed by telegram October 20, 1943. This telegram read in part as follows:

> "We confirm telephone purchase from you for prompt shipment by Pacific Intermountain truck following onion seed 20 bags Yellow Globe Danvers 2.50 * * * all onion 90% or better germination fob Stockton net cash. Airmail invoice and will airmail remittance or draft Colorado National if you prefer. (signed) The Barteldes Seed Co." (Pltf. Exh. 5, R. p. 110.)

Also Appellee sent a letter to Appellant confirming the sale dated October 21, 1943. In this letter Appellee again confirmed the purchase and confirmed the wire and said *"We understand that these stocks are all choice-quality stocks true to type."* (Pltfs. Exh. 6, R. pp. 111, 112.)

"Yellow Globe Danvers" is a particular variety and type of onion well known to the seed trade throughout the United States, and uniformly and generally recognized by the seed industry as possessing certain qualities and characteristics. It is impossible of course to recognize or identify the variety or type of onion seed from an examination of the seed itself. This can be determined only by growing the seed. Accordingly a buyer must rely upon the seller's designation, description and representation of variety. (Findings, R. pp. 31, 32; also R. p. 58.)

Thereafter, the seed was shipped and a bill of lading with an "arrival draft" attached was forwarded and the draft was honored and delivery of the seed accepted about October 28, 1943 at Denver. (R. p. 51.)

The seed was relabeled by Appellee and was resold. One of the purchasers, Dutch Valley Growers, planted the seed and when it was grown (as found by the court) "the said (onion) sets shrivelled, sprouted, decayed, kept poorly and did not have the typical characteristic shape or fine and desirable qualities of 'Yellow Globe Danvers' onion or onion set *and in fact was not 'Yellow Globe Onion' or onion set.*" (Findings, R. p. 34.)

Appellee promptly notified Appellant of said complaints and requested Appellant to inspect said onion sets and verify said complaints, which Appellant refused to do. (R. p. 34.)

Thereafter Dutch Valley Growers sued Appellee, Appellant was requested to defend and refused and Appellee was forced to and did defend. Dutch Valley

Growers recovered a judgment. It is for the resultant damages suffered by Appellee Barteldes Seed Co. that this action was brought.

Appellant contended at the trial that because a letterhead of Appellant mailed AFTER the contract was entered into contained a disclaimer of warranty of PRODUCTIVITY, this disclaimer relieved the seller of any obligation to ship goods of the description bought, namely "Yellow Globe Danvers" onions. This disclaimer is printed on the letterhead and is as follows:

> "The Standard Seed Farms Co. give no warranty, express or implied as to the *productiveness** of any seeds we sell and we will not be in any way responsible for the crop." (Pltfs. Exh. 9, R. p. 118.)

This letter was sent and received on October 20, 1943, which, as stated above, was after the contract had been entered into.

Apparently Appellant no longer relies upon this disclaimer which is not mentioned in his brief. Sole reliance is now placed upon an alleged disclaimer made in a printed form of contract included with the so-called "surplus list" which had been sent out to the trade, including Appellee, sometime before the oral contract involved here, was made.

This printed contract-*form* was a proposed agreement to be entered into between Standard Seed Farms Company (Appellant) as Seller and "....."

*Emphasis throughout is ours.

hereinafter called the Purchaser". In this form as paragraph 5 thereof there was printed: *"Except as herein otherwise expressly provided,* the Seller gives no undertaking or warranty, express or implied, as to description, quality, productiveness, or any other matter" etc.

This printed contract-form was never signed by any party, nor is there any contention that it was. The contract between the parties was, as stated above, an oral one made as hereinabove set forth in a telephone conversation. This contract-form was never referred to in the conversation, neither the contract-form as a whole nor the provisions of paragraph 5. In passing it may be noted that the language of the form "except as herein otherwise expressly provided" would imply that it was the custom of the seller to make specific exceptions in other sales from his policy not to warrant his seeds.

Contrary to the statement assumed by Appellant in his brief (without benefit of supporting Record reference) (App. Op. Br. p. 23), there is NO custom or usage of the seed trade in the State of California, or the United States or elsewhere that the seller of seed gives no warranty *as to variety or description.* On the contrary it is true that variety and description of onion seed CAN be controlled and it is known by growers and sellers of seed that it can be controlled. And *"there is no custom or usage of the seed trade * * * disclaiming warranty of variety or description."* (Findings IX, R. p. 37.)

The evidence fully supported this finding. Appellant's own witness, James William Hamilton, an expert called in for that purpose, testified that variety was a factor that could be controlled and known and the court found in accordance with his testimony that there was no custom of non-warranty of description. (Opinion, R. p. 27.)

THE HOLDING OF THE TRIAL COURT.

Under these facts the trial court held:

(1) A "consideration of the basic elements in the creation of a contract" solves the problem presented by this case. (Opinion, R. p. 24.)

(2) It is elementary that where an offer to buy certain goods at a certain price is accepted by a seller a contract is made. (Opinion, R. p. 24.)

(3) The contract "cannot be varied by additional terms or conditions, unless the parties mutually intend to alter the original agreement." (Opinion, R. pp. 24, 25.)

(4) A "disclaimer of warranty coming after the contract was completed is of no effect" and therefore a printed non-warranty clause appearing as a part of a letterhead in a letter sent after the contract was made is not a part of the contract. (Opinion, R. p. 25.)

(5) The agreement to sell "Yellow Globe Danvers" onion seed was an express warranty or condition

that the seed shipped was of that variety. (Opinion, R. p. 25.)

(6) A dealer in such a commodity selling it under that name is charged with notice that the buyer relies upon the description as a representation that it is the thing described. (Opinion, R. pp. 25, 26.)

(7) The manager of Appellee stated when the contract was being made that Appellee wanted only "first class quality stocks of high germination and true to type".

(8) This was not denied. (Opinion, R. pp. 26, 27.)

(9) An express warranty was made that the onion seed would be of the variety ordered. (Opinion, R. p. 27.)

WHERE A SALE OF SEED IS MADE BY DESCRIPTION THERE IS A WARRANTY (OR IT IS A CONDITION) OF THE CONTRACT THAT THE SEED WILL BE OF THE VARIETY SOLD. HENCE A CONTRACT FOR THE SALE OF "YELLOW GLOBE DANVERS" ONION SEED IS BREACHED WHERE ANOTHER VARIETY IS DELIVERED.

Appellee's cause of action is based upon contract and the sole issue here is whether there was a breach of contract. The question of whether the breach was also a breach of warranty, express or implied, or a breach of condition, isn't important. Appellee ordered "Yellow Globe Danvers" onion seed and Appellant breached his contract when he failed to deliver Yellow Globe Danvers onion seed. (Actually the breach was one of condition not warranty.) The goods were sold

by description (this is conceded by Appellant, Appellant's Op. Br. p. 11) and where goods other than goods of that description are delivered there is a breach.

The cases supporting this proposition have been collected and have been the subject of exhaustive annotation in 16 A.L.R. 871, 32 A.L.R. 1243, 62 A.L.R. 453, and 117 A.L.R. 473. In 16 A.L.R. at p. 871 it is said:

> "By the great weight of authority the sale of seed as of a certain kind—in other words a sale by description—constitutes a warranty that the seed is of the variety described, and this is especially true where the sale is by the grower. (The undertaking on the part of the seller is in some jurisdictions regarded as an express warranty, in others as an implied warranty, while in others it is regarded as a condition rather than a warranty.)"

In *Brandenstein v. Jackling,* 99 C.A. 438, 278 P. 880, there was an agreement by the seller to sell "No. 1 long grain Saigon rice". This phrase had a well-known meaning in the trade referring to a specific type and description of rice. The court held that the failure to ship such rice constituted not only a breach of an express warranty but a breach of contract. The court says (on p. 884 of Pac.):

> "The rule that a sale of goods by a descriptive name well known in the trade amounts to an express warranty simply holds one to deliver the goods which he has contracted to deliver. The

appellants' express written agreement to deliver No. 1 Saigon long grain rice would not be performed by the delivery of round grain or No. 2 rice or any other thing not described in the contract. As about 20 per cent. of the bags delivered contained rice of less value than the rice agreed upon, the buyer was entitled to damages for breach of contract. Considering appellants' failure to deliver all No. 1 rice as a breach of contract, instead of a breach of warranty of quality, the judgment appealed from would be equally well supported."

In *Newhall Land and Farming Co. v. Hogue-Kellogg Co.*, 56 C.A. 90, 204 P. 562 (1922), a ranch manager of plaintiff, a farming corporation, called at defendant seed company's warehouse in Ventura and discussed the purchase of "Wilson's improved bush lima beans" a type which could be grown successfully on the kind of land farmed by plaintiff's tenants. The seeds were bought and planted and turned out to be another variety of lima beans not so adapted. The court held (on p. 564 of Pac.):

"Appellant's final contention is that the trial court erred in finding that the defendant guaranteed the seed sold to run true to type. Where an article of a particular variety or type is ordered by name and the seller purports to furnish the same, with or without any express statement that the article furnished is of the kind ordered, a warranty of the identity of the variety or kind arises. Flint v. Lyon, 4 Cal. 17, 21; Burge v. Albany Nurseries Inc., 176 Cal. 313; 168 Pac. 343; Firth v. Richter, 196 Pac. 277; Rauth v. South-

west Warehouse Co., 158 Cal. 54, 60, 109 Pac. 839."

In *Firth v. Richter,* 49 C.A. 545, 196 P. 277 (1920), the buyers ordered Valencia orange trees and the seller undertook to deliver Valencia orange trees. After the trees had been planted and when they commenced to bear, it developed that they were navel orange trees. The court in holding the seller liable for damages says (on p. 279 of Pac.):

> "No charge of bad faith is made herein, but, on the contrary, the court found and the parties admit that there was no such bad faith or deception; nevertheless appellant assumed the responsibility of selling those trees as Valencia orange trees, and there is nothing in the evidence showing any conduct on the part of respondents which would estop them from claiming the benefit of the warranty. The terms used were sufficient to state an express warranty. *Polhemus v. Heiman,* 45 Cal. 573, 578, 579."

See also *Barrios v. Pac. States Trading Co.,* 41 C.A. 637, 639, 183 P. 236, 237; *Poter v. Gestri,* 77 C.A. 578, 247 P. 247.

The case of *Rocky Mountain Seed Co. v. Knorr* (1933), 92 Colo. 320, 20 P. (2d) 304, is in point. There the Plaintiff-in-error was in the retail seed business and the Defendant-in-error bought what she thought was alfalfa seed and what was sold as alfalfa seed but what turned out to be sweet clover. In the invoice there was a disclaimer of description and productiveness which in modified form appeared on the seller's

bags and tags. The seller offered to prove a custom of the trade to refuse to warrant seeds. The trial court refused to receive this evidence and the Supreme Court of Colorado sustained it saying (on p. 305):

> "It will be observed that defendant's contention is not that the delivery was short in quantity, or was lacking in productiveness, or was an inferior kind of alfalfa, or that the crop failed, but rather that on a purchase of alfalfa seed plaintiff made delivery of sweet clover seed. In the circumstances defendant's cause of action is grounded, not on breach of plaintiff's warranty, but for breach of contract to deliver what was purchased."

The *Rocky Mountain Seed Co.* case goes much further than it is necessary to go here. Here there was an express agreement to furnish seed "true to type" and Appellant's own evidence showed there was NO custom of the trade disclaiming a warranty of description.

In *Wallis v. Pratt* (1911) Appeal Cases, England, 394, there was a clause to the effect that the seller gave no warranty, express or implied, as to the growth, description, or any other matter, and the court held that this did not relieve the seller from liability where different variety was furnished than the seed stipulated for in the contract, and the court states:

> "If a man agrees to sell something of a particular description, he cannot require the buyer to take something which is of a different description and the sale or condition by description im-

> plies a condition that the goods shall correspond to it. But if a thing of a different description is accepted in the belief that it is according to the contract then the buyer cannot return it after having accepted it, but he may treat the breach of the condition as if it was a breach of warranty, that is to say, he may have the remedy applicable to a breach of warranty. That does not mean that it was really a breach of warranty, or that what was a condition in reality had come to be degraded or converted into a warranty. It does not become degraded into a warranty ab initio but the injured party may treat it as if it had become so and he becomes entitled to the remedy which attaches to a breach of warranty."

To the same effect was the holding in *Black v. B. B. Kirkland Seed Co.,* 158 South Carolina 112, 155 S.E. 268, where the court held that a non-warranty clause could have no application since the pertinent and only question was whether or not the rice seed sold was "abruzzi" as represented by the seller.

The following authorities are also in point:

46 Am. Jur. 566;

55 C.J. 778 (Sales, Sec. 742).

THERE WAS HERE A BREACH OF AN EXPRESS WARRANTY.

As stated above in this case the evidence showed and the court found that there was an express agreement in the telephone conversation wherein the contract between the parties was made that this Yellow

Globe Danvers onion seed was to be "first class stock of high germination *and true to type.*" This, the trial court found was an express warranty.

> "Any affirmation of fact or any promise by the seller relating to the goods is an express warranty if the natural tendency of such affirmation or promise is to induce the buyer to purchase the goods and if the buyer purchases the goods relying thereon * * *"
>
> (California Civil Code 1732.)

This is a codification in California of Sec. 12 of the Uniform Sales Act. Regarding this section it is stated by Williston on Sales Rev. Ed. 1948, Sec. 194 at pp. 500, 501:

> "The Sales Act makes it clear that an affirmation of fact (that is a representation) is a warranty and not merely evidence of a warranty, if its natural tendency is to induce the buyer to purchase the goods and the buyer thus induced does purchase them."

NO DISCLAIMER OF LIABILITY FOR MISDESCRIPTION CONTAINED IN A PRINTED CONTRACT-FORM MAILED TO THE TRADE PRIOR TO THE CONTRACT AND NOT FORMING ANY PART OF THE CONTRACT ENTERED INTO, AND NO DISCLAIMER OF LIABILITY FOR PRODUCTIVENESS CONTAINED IN A LETTERHEAD OF THE SELLER IN A LETTER MAILED AFTER THE CONTRACT WAS MADE CAN BE RELIED UPON TO ESCAPE LIABILITY.

The court has found here and the evidence would have justified no other finding, that there is in the seed trade no custom or usage disclaiming warranty

of variety or description. The reason for this is obvious. Type and variety can be controlled and are within the knowledge of the seller. As the court found, Appellant's own expert testified that variety was a factor that could be controlled and known. "Therefore the rationale which would be the basis for the custom was lacking." (Opinion, R. p. 27.)

The goods having been described as "Yellow Globe Danvers" onions, there was a warranty that they were of this variety which was implied as well as express.

Appellant actually concedes this in his brief (Appellant's Op. Br. pp. 11 and 12), where he says:

> "The logical effect of a sale of goods by description is brought forth in the California Civil Code, in section 1734, which states: 'that where there is a contract of sale or a sale of goods by description there is an implied warranty that the goods shall correspond with the description."

The sole evidence to which Appellant refers in his brief to support his claim of disclaimer of liability for misdescription of the seeds is a paragraph of a printed contract-form which was included with the "surplus list" sent out to the trade by Appellant prior to the making of this contract. (App. Op. Br. p. 12.)

We have already noted:

(1) There was no mention made of this contract provision in any of the negotiations between the parties; there is no evidence in the record it was ever read by Appellee;

(2) It was not made a part of the contract between the parties;

(3) On its face it implies that exceptions were sometimes made by the seller;

(4) Since the record shows variety is within the grower's control and no custom of the trade involves a disclaimer of variety, no reason would exist for a non-warranty of description.

In this connection it is interesting to note that at the trial Appellant's counsel endeavored by "putting the words in the mouth" of Appellant Jones when he was a witness to get him to testify that there was a custom in the trade to disclaim liability for description. However, after objection to the leading question was sustained and when the question was put without suggestion of the answer it is significant that "productiveness" was the only non-warranty which was specifically mentioned by Jones. (R. p. 83.)

> "A. That was the accepted wording that the seller of these seeds gives no warranty as regards the purity, productiveness, or any other matter connected with the sale of the seed, *the productiveness of the product.*" (R. p. 84.)

We do not believe any citation of authority is required to sustain the proposition that a printed contract-form included in a surplus list sent out by the seller, not shown to have been brought to the attention of the buyer, not entering into or forming any part of the negotiations and not mentioned in the final contract entered into, can not be said to constitute any

part of the contract. To claim the contrary would be a manifest absurdity.

Nor can any greater weight be accorded the disclaimer clause contained in the printed letterhead of the seller in a letter which was mailed out *after* the contract was made.

In the first place, this disclaimer is only a disclaimer of liability for *productiveness*. Description—the obligation to furnish a seed true to type—is not even mentioned in this disclaimer. (R. p. 118.) And the omission of such non-warranty in the disclaimer clause shows actually that far from being the intent of the grower to disclaim liability for description it was his intent to be bound to furnish the type of seed included in the description.

Even had the disclaimer been one of liability for misdescription, coming after the contract was made, it could serve no purpose.

We have already recited the facts in *Newhall Land and Farming Company v. Hogue-Kellogg Co.*, 56 C.A. 90, 205 P. 562 (1922), which facts are so similar to the facts here. There the court says (on p. 565 of Pac.):

> "It is urged by the appellant, however, that * * * there was printed upon stationery of the defendand—and thereby through its correspondence * * * brought to attention of the (plaintiff) that the defendant 'gives no warranty, express or implied, as to description, quality, productiveness or any other matter.' * * *

"But this was after the making of the contract of sale of the seeds and it is held in accordance with elementary principles that the terms of a contract duly entered into cannot be changed except with the concurrence of all parties * * *"

THE CASES CITED BY APPELLANT ARE NOT IN POINT. ALL OF THEM INVOLVE SALES WHERE (1) A DISCLAIMER, OR NON-WARRANTY CLAUSE, WAS MADE AN EXPRESS PART OF THE CONTRACT, OR (2) WHERE THERE WAS A GENERAL CUSTOM OF NON-WARRANTY IN THE TRADE FOUND BY THE FACTS TO EXIST, OR BOTH. NEITHER OF THESE CONDITIONS EXIST HERE.

Appellant has cited a number of cases typical of which are *Ross v. Northrup* (1914), 156 Wis. 327, 144 N.W. 1124, and *Miller v. Germain Seed & Plant Co.* (1924), 193 Cal. 62, 222 P. 817, which hold that an express disclaimer of liability made a part of the contract, or a general custom of the trade not to warrant, will negate the implied warranty of description or productiveness (usually the latter).

Principal reliance is placed by Appellant upon the case of *Miller v. Germain Seed and Plant Co.* (1924), 193 Cal. 62, 222 P. 817. The case is clearly not in point. In the *Miller* case there was evidence of a trade custom disclaiming warranty *as to description* AND productiveness. The seller offered an instruction to the jury which included the following (on p. 818 of Pac.):

"* * * if in this case it should appear from the evidence that there is a general custom or usage of the seed trade that no seeds are warranted as to name, description, productiveness, or other

matter, and if you find from the evidence that such custom is so universal that it must be presumed to have been known by people who have transactions in the seed business, then I charge you that such custom or usage is as much a part of the contract of purchase and sale as if it had been expressly so stipulated."

The trial court had refused to give this instruction and the Supreme Court held this was error. In the *Miller* case there was NO express warranty. The seller had NOT agreed as Appellant Jones agreed here that the seed were "true to type." It was not true there as it is true here that there is NO custom of non-warranty of description. The court says (on p. 818 of Pac.):

"It may be conceded that where a purchaser asks a seed dealer for a certain variety of seed, and in pursuance of that request seed is furnished, in the absence of any additional facts the law will, from the transaction, imply a contract of warranty. This warranty partakes of the nature of both an express and implied warranty. It is express in the sense that it is based upon the express language used by the purchaser in his order or request; it is implied in the sense that results from the circumstance that the request for seed is from a grower of celery to a seller of celery seed for the purpose of raising celery plants, and therefore the character of the seed is an essential and vital provision of the contract between the parties. *It is, of course, conceded that if there had been a written warranty or an expressed oral warranty of the character of the seed, the cus-*

> *tom of the dealer in other cases not to give such a warranty would have no bearing upon the terms of the express warranty.* The question here is somewhat different, namely, whether or not in determining the contract between the parties we should consider, not only the character of the business conducted by the purchaser and by the seller, but also the general custom of seed dealers not to warrant the character of seed sold by them."

Thus the *Miller* case is not authority for Appellant. It is authority for Appellee.

All of the other cases cited by Appellant can be similarly distinguished.

Ross v. Northrup (1914), 156 Wis. 327, 144 N.W. 1124, was a case in which the evidence not only showed but the jury found a general custom of non-warranty; also an express disclaimer was made a part of the contract; and there also the court recognized that had there been there, as there is here, an express warranty of description, no general custom could be proved to contradict it.

Lehnr v. Germain Seed Co. (1924), 192 Cal. 782, 222 P. 843, was a companion case to the *Miller* case, follows it in the reports and the *Miller* opinion is adopted.

William A. Davis Co. v. Bertrand Seed Co. (1928), 94 C.A. 281, 271 P. 123, cited and quoted from by Appellant (App. Op. Br. pp. 15-17) is again illustrative of the distinction between cases where there is an

express warranty and cases where there is an express refusal to warrant negativing an implied warranty. The court points out this distinction in its comment upon the *Miller* case, where it says (on p. 127 of Pac.):

> "In that case, both in the prevailing and dissenting opinion, the rule was conceded, as it is in the case at bar, that 'where a purchaser asks a seed dealer for a certain variety of seed and in pursuance of that request the seed is furnished, that in the absence of any additional facts the law will from the transaction imply a contract of warranty. This warranty partakes of the nature of both an express and implied warranty.' "

Sutter v. Associated Seed Growers (1939), 31 C.A. (2) 543, 88 P. (2d) 144 (cited App. Op. Br. p. 17) did not involve a breach of warranty (or condition) of description. There the question was one of productiveness. There also the provision in a written contract warranting productiveness had been expressly stricken out at the insistence of the seller. It was of course held that the parties by their express contract could negate liability for productiveness.

It is unnecessary to note separately all of the cases cited by Appellant in its brief (App. Op. Br. p. 18) on the question of the validity and extent of agreements containing express disclaimers of non-warranty, or containing proof of findings of general customs negating implied warrants. All of them are distinguishable from the instant case upon the facts noted.

NO QUESTION OF CONFLICT OF LAWS IS PRESENTED HERE. UNDER THE LAW OF ALL JURISDICTIONS THE SELLER IS LIABLE ON THE FACTS OF THIS CASE AND THERE IS NO CONFLICT BETWEEN THE CALIFORNIA LAW AND COLORADO LAW. HOWEVER, THIS CONTRACT WAS PERFORMED IN COLORADO, AND ITS LAW IS APPLICABLE HERE.

The questions presented in this case offer no conflict of laws. We do not know why the Appellant raises, in this court, the contention that the law of California and not the law of Colorado applies. As far as we can see, the rule is uniform that where there is an express agreement to furnish Yellow Globe Danvers onions true to type, the seller is bound by his agreement.

It is true that had there been a disclaimer made by the seller here as a part of his contract, and had there been a custom of the trade shown to disclaim liability for misdescription, then the law of Colorado as embodied in the case of *Rocky Mountain Seed Co. v. Knorr,* 20 P. (2d) 304 is stronger than in some jurisdictions. But as shown above no disclaimer as a part of the contract and no custom exists here; therefore the question of place of performance is academic.

To meet counsel in this argument we would point out that the contract between the parties is to be performed in Colorado and therefore the law of that jurisdiction is applicable.

Restatement of Conflict of Law ALI says:

"Sec. 355. Place of Performance.

The place of performance is the state where, either by specific provision or by interpretation

of the language of the promise the promise is to be performed."

"Sec. 372. Right to Damages and Measure of Damages.

The law of the place of performance determines the right to damages for a breach of contract * * *"

The authorities fully support this rule.

Bertonneau v. S. P. Co. (1917), 17 C.A. 439; 120 P. 53;

Flittner v. Equitable Life Assur. Soc., 30 C.A. 209; 157 P. 630;

Pray v. Trower Lumber Co. (1940), 101 C.A. 482; 281 P. 1036;

Blair v. N. Y. Life Co. (1940), 40 C.A. (2d) 494; 104 P. (2d) 1075;

Hayter v. Fulmor (1944), 66 C.A. (2d) 554; 152 P. (2d) 746;

Monarch Brewing Co. v. Meyer Mfg. Co., 130 F. (2d) 582;

Tuller v. Arnold, 93 Cal. 166; 28 P. 863.

The failure of the performance to deliver Yellow Globe Danvers onion seed ordered by Appellee in this case occurred in Colorado when the seed was delivered to it in Denver after it had paid the draft attached to the bill of lading. The fact appellant paid the freight from California is of no significance in this case, because the title to the seed did not pass to Appellee until the seed was paid for and delivered in Denver.

In *Puritas Coffee & Tea Co. v. DeMartini et al.,* 56 C.A. 628; 206 P. 96, at page 98, the court said:

> "* * * the fact that the bill of lading was made to the order of the plaintiff, with instructions to notify defendants, and that it was forwarded with sight draft attached to a San Francisco bank authorized to deliver to defendants only upon payment of the draft, clearly evidenced an intention on the part of plaintiff to reserve title and possession until payment of the draft. When the terms are cash, title does not pass until payment of the price. *People v. Sing,* 42 Cal. App. 385; 183 Pac. 865, 867; *Katzenbach & Bullock Co. v. Breslauer* (Cal. App.) 197 Pac. 967, 968. And in the absence of an agreement to the contrary, the risk of loss is assumed by the party having the title. *Henderson v. Lauer & Sons,* 40 Cal. App. 696, 698; 181 Pac. 811; *Potts Drug Co. v. Benedict,* 156 Cal. 322, 334; 104 Pac. 432; 25 L.R.A. (N.S.) 609."

It is generally held, where there is a shipment of goods to the seller or order and a sight draft drawn against the buyer for the purchase price is attached to the bill of lading and forwarded for collection, that the seller thereby manifests an intention to preserve his property in the goods, and that title does not pass until the draft is paid. While the cases are concerned primarily with the question of when title passes, the inference is that the title passes at the place of destination, when the draft is paid and the bill of lading is delivered. 60 American Law Reports Annotated, page 677.

Reynolds v. Scott (1884), 2 Cal. Unrep. 334, 4 Pac. 346; *Ramish v. Kirschbraum* (1895), 107 Cal. 659, 40 P. 1045; *Puritas Coffee & Tea Co. v. DeMartini* (1922), 56 C.A. 628, 206 P. 96.

CONCLUSION.

The only other point raised by Appellant, the alleged error in Paragraph III of the Findings of Fact, is without merit. The paragraph is in complete accord with the evidence, no part of the reporter's transcript is cited which negates the facts there found. Actually the fact found is immaterial so far as it relates to the place of delivery.

Dated, Sacramento, California,
May 2, 1951.

Respectfully submitted,
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No. 12,735

United States Court of Appeals

For the Ninth Circuit

H. L. JONES, individually and doing business under the style and trade name of STANDARD SEED FARMS COMPANY,

Appellant,

vs.

THE BARTELDES SEED COMPANY (a corporation),

Appellee.

APPELLANT'S CLOSING BRIEF.

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APPELLANT'S CLOSING BRIEF.

THE EFFECT OF THE NON-WARRANTY CLAUSE.

The appellee throughout his brief contends that the non-warranty clause as shown in the surplus list, plaintiff's exhibit No. 7, was never referred to in the conversation which resulted in the formation of the contract which is the subject of this action; that there is no evidence in the record that it was ever read by appellee; and that the non-warranty did not become a part of the contract.

The facts, themselves, contradict this contention. The facts on page 49 of the transcript of the record

reveal that Mr. Stubbs described the surplus list as follows: "It quoted numerous items which they offered *subject to being unsold,* which included two thousand (2,000) pounds of Yellow Globe Danvers onion seed." He states that he telephoned Mr. Jones on October 20th, 1943, immediately upon the receipt of the list. When asked to state fully what was said in the conversation Mr. Stubbs replied "I told him (Jones) that we had his surplus list, and that we would purchase *the* two thousand (2,000) pounds of Yellow Globe Danvers onion seed at $2.50 per pound which he quoted in the list at $3.00 a pound."

This contract arose when the Barteldes Seed Company received the surplus list offering certain onion seeds for sale.

Mr. Stubbs recalled that the items were offered subject to being unsold which was a term set forth in the surplus list, yet the appellee claims he did not notice the non-warranty clause. It is quite obvious that Mr. Stubbs read the surplus list and noted the provision that the seeds were offered subject to being unsold and he offered to buy *the* two thousand (2,000) pounds of Yellow Globe Danvers onion seed that were offered in the surplus list under the terms of the surplus list. With these facts it is difficult for the appellant to concede the fact that the disclaimer clause was not called to the attention of Mr. Stubbs, since it was plainly printed on the surplus list from which he ordered the seed. It is more difficult to understand the appellee's contention that the disclaimer clause as

shown in the surplus list was not brought to the buyer's attention, when we consider the fact that as shown in plaintiff's exhibit No. 6, that the Barteldes Seed Company had printed on its own letter-head that "the Barteldes Seed Company gives no warranty, expressed or implied, as to purity, description, quality, productiveness or any other matter of any seeds, bulbs or plants they send out and will not be in any way responsible for the crop." On page 107 of the Record, Armin Barteldes testified that he thought he knew the general custom in the seed business until the Dutch Valley case (the adverse decision to the Barteldes Seed Company denying the validity of the seedmen's disclaimer clause) came on. He readily admitted that in October, 1943, that the Barteldes Seed Company used the general seedmen's disclaimer as shown on the letter-head of the Barteldes Seed Company in plaintiff's exhibit No. 6.

The courts dealing with the non-warranty or disclaimer clause have had this argument brought before them that the purchaser was not aware of the non-warranty provisions in the offer of sale.

The case of *Ross v. Northrup* (1914), 156 Wis. 327, 144 N.W. 1124, 160 A.L.R. 361, having the same contention before it, stated:

> "The business was transacted by mail. Where the book from which the order was given, the shipping tag and the invoice all stated these conditions, it would be unreasonable to hold that any blame attached to the defendant if Morton (plaintiff) failed to observe all of these things.

> Mr. Morton could not close his eyes to the information that was literally staring him in the face then hold the defendant liable."

The case of *Davis v. The Bertrand Seed Company* (1928) in 94 Cal. App. 281, 271 P. 123, also had this contention. The facts of the case, and letter offering the seed for sale, had printed upon it the general non-warranty clause "that while we exercise great care to have our seeds pure and reliable, we give no warranty, expressed or implied, as to description, quality, productiveness, or any other matter of any seeds we send out, and we will be in no way responsible for the crop. If the purchaser does not accept the goods on these terms, they are at once to be returned."

The *Davis* case held on the authority of the ***Miller v. Germain Seed*** case, 193 Cal. 62 (1924), 222 Pac. 817, 32 A.L.R., 1215, that:

> "In the case cited (Miller case) as already indicated sofar as the rights between the parties are concerned it was found there was no writing, printed or otherwise, between the parties disclaiming expressed or implied warranty that the seeds were of the variety known as 'Golden Yellow Celery, California.' "
>
> "But the Court held that the above instructions (that if there was a general custom of non-warranty the plaintiff would be bound thereby, even if he did not know of such custom and usage) should have been given so that the jury if they so found could, as against a *farmer* purchasing

seed for use, nullify the foregoing 'expressed or implied warranty', by a mere custom unknown to the buyer himself. *And we emphasize the following portion of the opinion* (Italics ours):

'And by a parity of reasoning which lead the Court to arrive at the foregoing conclusion, it would seem to follow that as between *two sophisticated wholesale seed corporations,* an express disclaimer of warranty inserted in their mutual correspondence should have even greater potency as to disclaimer or warranty than the seed seller's custom which bound the farmer in the Miller-Germain case.' "

To what extent a buyer must go in order to ascertain the existence of a disclaimer or warranty clause is brought out in the case of *Henry v. Salisbury,* (1897) 14 App. Div. 526, 43 N.Y.S. 851, where the fact that a catalogue was called supplemental was sufficient to charge the buyer with knowledge of the contents of the preceding or main catalogue in which the non-warranty clause was printed, the Court held:

"That to hold defendant liable we must first be able to point to a warranty in his behalf. The statement as to the age of May Day (a horse) contained in the supplemental catalogue and relied upon as stating a warranty in this case cannot properly be treated as such, because of the notice contained in the preceding catalogue, to the effect that the age of the horse was not guaranteed. The ignorance of that notice, if ignorance existed on the part of the purchaser, cannot be allowed to turn the statement in the supplement

> into a warranty. It was plainly his own fault if he did not ascertain what the principal catalogue said in regard to the ages of the animals to be sold."

When we analyze the facts in our case and the law above quoted, our logical conclusion is that the appellee knew, or should have known, and was put on notice as to the non-warranty provision in the offer to sell. The mere fact that the contract was made orally by telephone would not abrogate or destroy the foregoing non-warranty clause and make into a warranty words that were merely set forth giving the seller's opinion in good faith as to the type and description of the seeds which he had for sale.

ABSENCE OF EXPRESS WARRANTY.

The appellee in his brief frequently stated that an express warranty was made, that the seeds sold were true to type. Let us first examine the record to see on what facts this assertion is based.

The only testimony upon which this assertion could be based is that of W. P. Stubbs on page 50 of the transcript of record. His testimony there was "I told him at the time we wanted first class quality stocks of high germination and true to type and he assured me that the stock were of *first class quality* and of *high germination.*" He testified, on page 50 of the record, that there was nothing said about limitation or liability nor was there anything said about non-war-

ranty. He stated there was nothing said about the possibility of the seed not being Yellow Globe Danvers. This is the entire testimony in the record upon which appellee can base an expressed warranty that the onion seed shipped was expressly warranted to have the characteristics of Yellow Globe Danvers.

The California Civil Code in Section 1732 defines an express warranty as follows:

> "Any affirmation of fact or any promise by the seller relating to the goods is an express warranty if the natural tendency of such affirmation or promise is to induce the buyer to purchase the goods, and if the buyer purchases the goods relying thereon. No affirmation of the value of the goods, nor any statement purporting to be a statement of the seller's opinion only shall be construed as a warranty".

The facts in this case show that there was no express warranty. The Court in its Findings of Fact on page 32 of the transcript of record found that "it is impossible by examination, inspection or otherwise to recognize or identify the variety or type of any onion from the seed thereof. The variety and type can be determined only from the sets of matured onions after the seed is planted and grown". There is no doubt that the appellee, a wholesale dealer in seeds for many years, knew that the variety of onion seed could not be determined from the observation of the seed itself, and that the only way that the variety of onion could be determined would be to plant the seed and wait until the seed matured into an onion. They also knew that

when Mr. Jones told them that he had two thousand (2,000) pounds of Yellow Globe Danvers onion seed that Mr. Jones himself could not determine from an inspection of the seed that it was Yellow Globe Danvers onion seed, and that at most his statement was merely his opinion as to the variety of onion which the seed would produce, and he did not and could not confirm the fact that the seed would mature into Yellow Globe Danvers onion. The appellee contends that the assertion by Mr. Stubbs that he told Mr. Jones he wanted only first-class quality stock of first class germination and true to type, and that Jones assured him that the stocks were first class quality and of *high germination* that the words used were an express warranty of *description* of the seeds on its face is absurd. Mr. Jones did not even mention the word "description" nor did he mention the fact that the seeds would be true to type. Nothing was said about warranty or non-warranty, and nothing was said about the fact that the Yellow Globe Danvers onion seed might not in reality have the characteristics of Yellow Globe Danvers. In the case of *Belt Seed Company v. Mitchelhill Seed Company* (1941) in 238 Mo. App. 142, 153 S.W. (2d) 106, it was held that the statement "ger. 80" was not an express warranty that the germination of the seed would be 80%, but it was held that the quoted words were merely an expression of an opinion and not a warranty in view of the express disclaimer of warranty as to description, quality, productiveness, or any other matter printed in the first

paragraph of the communication of sale and other written communication passing between the parties.

As shown in the appellant's opening brief the case of *William A. Davis v. Bertrand Seed Company* (1928) 94 Cal. App. 281, 271 Pac. 123, showed that the statements such as these are not incompatible with the non-warranty clause and they reconcile the two,

> "The language relied upon should be and can be construed in the reasonable sense which will preserve and not do violence to the plain meaning of the expressed language of the non-warranty clause; and be construed merely in connection with the statement touching care in selection and expressive of an opinion in good faith as to the general merits of the defendant's stock in trade."

It is unreasonable to assume that a corporation which itself relies upon a non-warranty clause would accept these words as constituting an express warranty when they could have exacted their terms and conditions in the making of a contract which would have made an express warranty.

CUSTOM AND USAGE IN THE SEED TRADE.

The appellant contends that upon reading the testimony of H. L. Jones, Cyrus Voorhies and James Hamilton that there was a custom and usage in the seed business to use non-warranty clause.

The appellant realizes that about the time of the sale of the seed in question the seedmen were using two different types of non-warranty clauses and this had brought much confusion into the testimony of Jones, Voorhies and Hamilton. But whether or not the exact non-warranty clause was known by these witnesses at the time of the sale in question, they all testified there was some type of non-warranty clause in existence. They all agreed that the seller of the seeds would not expose himself to full and complete liability in the sale of seeds. We have constantly maintained that there was a custom and usage in the seed business not to warrant or to accept full responsibility in the sale of seeds. This has been disputed by the appellee, but even the appellee's own witness, Armin Barteldes, on page 108 of the transcript of record was confused as to non-warranty clause which was in existence and stated that his company, the appellee, used the non-warranty clause as shown in plaintiff's exhibit No. 6, in which they expressly denied any responsibility for the mis-description of the seeds. The custom and usage is brought out not to contradict the expressed terms of the contract but to establish what the parties had in mind when the contract was made.

> "A uniform trade custom is readily accepted by courts to define what is ambiguous or is left indeterminate in a contract, where both parties have knowledge of the custom, or are so situated that such knowledge may be presumed, for the reason that the majority of such transactions are had in view of the custom, and the agreement on which

> the minds of the parties actually met will thereby be carried into effect. * * * Where the custom is proved to be known to both, it may even add terms to the contract. * * * Where the custom is *general* it will be presumed to have entered into the contract, and one may be bound thereby although ignorant, unless the other party be shown to have knowledge of his ignorance. * * *"
>
> *Miller v. Germain Seed Company,* supra;
>
> *Ross v. Northrup,* supra.

On page 84 of the transcript of record appellant, H. L. Jones testified that the usual seedmen's disclaimer was that they give no warranty as regards purity, productiveness, or any other matter connected with the sale of seeds and that they would not be responsible for the product.

On page 96 of the record Cyrus F. Voorhies testified that the custom was that you do not guarantee the productiveness of the seed sold, the productiveness and the other *varieties,* type, et cetera.

On page 105 of the transcript of the record James Hamilton testified: "The old disclaimer was the one where there was germination, *variety,* and so forth and so on. * * *"

Nowhere in the entire record is there any testimony that it was not the custom and usage of the seedmen not to warrant or that any seedmen did accept full responsibility for the seeds they sold.

As this is the only testimony given on the disclaimer clause the appellant contends that there are no facts whatsoever that the Court could base its findings that

there was no custom and usage in the seed business not to warrant the sale of seed. Findings of Fact No. IX on page 27 of the record.

The trial Court expressed the opinion that there is no rationale to the non-warranty clause. He bases his reasoning as is shown on page 27 of the transcript of record on an ambiguous answer to a compound question.

The custom and usage as testified to by Cyrus F. Voorhies on page 96 of the record was in existence throughout the United States "before my time." Armin Barteldes on page 108 of the transcript of record also testified it was the general custom in the seed business *not to warrant.*

The appellant feels that the trial Court did not have before it enough evidence to call a universal custom of one of the largest industries in the United States that has been in existence many years irrational. The Supreme Court of the State of Utah has this to say about the rationality and the practical aspects of the seedmen not to warrant:

> "As shown by the cases, the so-called disclaimer of warranty which seedmen variously print on containers, tags, and cards placed in the packets is a matter of importance in a transaction involving the sale of seed. The risks and dangers that threaten a crop between the planting and the harvesting are numerous. If the seed merchant could not protect himself by custom not to warrant or by a disclaimer of warranty, he would find it hard to survive the litigation that would come to his door. The purchase price of a parcel

of seed is usually insignificant as compared with the value of the crop that may be raised therefrom. For this small price the seed merchant may feel that he cannot afford to warrant."

REFUTATION OF APPELLEE'S AUTHORITY.

The appellee contends that the law of the State of Colorado should govern the performance of this contract and as his authority cites the case of *Puritas Coffee and Tea Company v. De Martini, et al,* 56 Cal. App. 628, 206 Pac. 96, at page 98, a case decided in 1922, prior to the adoption of the Uniform Sales Act. We have discussed this in our opening brief, starting on page 7. He then relies upon the authority of the *Rocky Mountain Seed Co. v. Knorr* (1933), 92 Colo. 320, 20 P. (2d) 304. This case has been distinguished by the authorities. The case of *Kennedy v. Cornhusker Hybrid Co.* (1946), 146 Neb. 230, 19 N.W. (2d) 51, 160 A.L.R. 351, held:

"Plaintiff's case is not comparable with those where a party purchased *timothy* and was delivered *millet,* or purchased *alfalfa* and was delivered *sweet clover,* or, as stated by plaintiff, purchased a *cow* and was delivered a *horse.* Cases cited by plaintiff in support of his contention are obviously distinguishable and have no application to the case at bar. The distinction is clearly demonstrated by a statement which appears in one of the cases relied upon by plaintiff. In Rocky Mountain Seed Co., v. Knorr, 92 Colo. 320, 20 Pac. (2d) 304, 305, it was said: 'It will be observed that defendant's (buyer's) contention is

not that the delivery was short in quantity, or was lacking in productiveness, or was an inferior kind of alfalfa, or that the crop failed, but rather that on a purchase of alfalfa seed plaintiff made delivery of sweet clover seed. * * *' And that is the distinction which the authorities recognized."

CONCLUSION.

Under the conclusion the appellant respectfully submits to this Court that the trial Court erred in not finding that the disclaimer clause as set forth in appellant's surplus list, plaintiff's exhibit No. 7, expressly negatived any expressed or implied warranty in the description, purity, productiveness, or any other matter of the seeds sold.

That the Court erred in not finding that the custom and usage in the seed business became an integral part of this contract, and was in the minds of the parties when the contract was confirmed and negatived any expressed or implied warranty as to the description, purity, productiveness or any other matter of the seeds sold.

Dated, Stockton, California,
May 14, 1951.

Respectfully submitted,
JAMES I. HARKINS,
ALBERT E. CRONIN, JR.,
Attorneys for Appellant.

No. 12,735

IN THE

United States Court of Appeals

For the Ninth Circuit

H. L. JONES, individually and doing business under the style and trade name of Standard Seed Farms Company,

Appellant,

vs.

THE BARTELDES SEED COMPANY (a corporation),

Appellee.

APPELLANT'S PETITION FOR A REHEARING.

JAMES I. HARKINS,
ALBERT E. CRONIN, JR.,
300 American Trust Company Building, Stockton 5, California,
Attorneys for Appellant and Petitioner.

Table of Authorities Cited

Cases

Texts

No. 12,735

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THE BARTELDES SEED COMPANY (a corporation),

Appellee.

APPELLANT'S PETITION FOR A REHEARING.

To the Honorable William Denman, Chief Judge, and to the Honorable Associate Judges of the United States Court of Appeals for the Ninth Circuit:

H. L. Jones, the Appellant in the above entitled cause, respectfully petitions for a rehearing in order that further consideration be given to certain legal principles upon which the opinion rendered in this cause is predicated.

The Appellant urges that a rehearing is justified in this cause on the following grounds:

I.

The trial Court erroneously stated the facts. The opinion herein contains the following:

> "The Appellant, a grower and seller of vegetable seeds, with his principal place of business located in Stockton, California, sent his customers a 'Surplus List', showing the seeds he had in stock and the prices asked. Attached to the 'Surplus List' was a blank form of contract of sale."

The Court's statement of facts in this matter is clearly shown to be erroneous by referring to Plaintiff's Exhibit No. 7 which was printed on page 113 of the transcript of record.

In the oral argument before this Court, the counsel for the Appellee urged the Court that two documents were sent out—a Surplus List and a Contract of Sale. Because it is difficult for this Court to ascertain from the transcript of record the precise form this "Surplus List" was sent out in, we are attaching hereto a photostatic copy of the "Surplus List" for the Court's inspection. The Court will note that there is no attached contract, but in reality there was only one form submitted on one page with printing on one side, offering certain onion seeds for sale.

The Court, in its opinion, does not seem to have a clear understanding of just exactly what a "Surplus List" is.

The "Surplus List" used by the Appellant was in the form of a contract to grow vegetable seeds. When the Appellant stamped the contract to grow

seeds, with the words "Surplus 1943 Crop", he changed this form from a Contract of Sale into a price list. On page 42 of the transcript of record, we find the following:

"Q. Mr. Jones, I am going to show you this photostatic copy which you were shown on direct examination. I believe it is a photostatic copy of Plaintiff's Exhibit No. 7. Isn't this, Mr. Jones, just a form of printed contract which you were then using under the terms of which you agreed to grow seeds for various purchasers?

A. That is correct, modified by the words 'Surplus 1943 Crop'. If you put the word 'Surplus' on there, it is not an agreement to grow.

Q. In other words, in this particular case, in lieu of furnishing a regular price list, you used one of your contract forms, and distinguished it by putting the word 'Surplus' on it. Is that right?

A. It amounts to the same thing.

Q. It wasn't exactly the same, was it, as your usual price list?

A. It is about the same as my usual price list.

Q. Well, do you use this all the time as a price list?

A. Yes.

Q. I believe you testified on direct examination that 3200 pounds was the total of your crop of yellow globe Danver onions grown or in the warehouse at the particular time that you made your sale to the Barteldes Seed Company?

A. As near as I can recall, that was the testimony and that was the fact."

Mr. Stubbs, the manager of Barteldes Seed Company, who entered into this contract with the Appellant, was in the seed business for at least twenty-five years at the time of the making of this contract. The Court will note, in referring back to Mr. Stubbs' testimony on pages 48 and 49 of the transcript of record, that Mr. Stubbs speaks of the document he received from the Standard Seeds Farm Company as a "Surplus list". The fact that he wasn't confused as to the nature of a "Surplus List" is shown by the fact that he immediately called the Appellant on long distance telephone and offered to buy seeds that were offered for sale for immediate delivery. This is also shown in the various exhibits in the transcript of record confirming the sale "For Prompt Shipment". It is the contention of this Appellant that the "Surplus List" was definitely within the area negotiated and was covered by the telephone conversation which formed this contract, and that the purchaser knew, or should have known, that the provisions of the "Surplus List", disclaiming liability for Breach of Warranty in the description of the onion seeds was truly applicable to this sale. The law covering the application of the usual seedman's disclaimer has been stated at greater length on page 12 to page 19 of the Appellant's Opening Brief.

The Court will note that the disclaimer sent out in the Surplus List read as follows, "Except as *herein* otherwise expressly provided * * *", after which came the usual seedman's disclaimer.

The Court then reasoned that the disclaimer provided for exceptions to the non-warranty provisions and the words uttered concerning variety by the *Appellee* to the *Appellant* constituted such an exception on the part of the Appellant. This is clearly erroneous. The disclaimer can only be interpreted to mean that unless a definite warranty were given in the surplus list itself, then no warranty would be given.

II.

The opinion of this Court stated that,

> "Disagreement existed between counsel for appellant and appellee as to whether the law of California or that of Colorado should be applied in construing the contract. We think it immaterial because both California and Colorado have adopted the Uniform Sales Act, which, in our opinion, governs the transaction in issue here".

The Appellant notes that this is a unique statement of the law, and is not backed by any citation of authority. We submit to the Court on this issue the following authorities:

Federal Courts, in diversity of citizenship cases, are governed by the conflict of laws rules of the Courts of the states in which they sit.

Griffin v. McCoach (Texas, 1941), 61 S. Ct. 1023, 313 U.S. 489, 85 L. Ed. 1481, 134 A.L.R. 1462.

> "Where jurisdiction of a Delaware Federal Court was based on diversity of citizenship, the

> Supreme Court's views were not the decisive factor in determining the applicable conflicts rule, and the proper function of the Del. Federal Court was to ascertain what the state law was and not what it ought to be."
>
> *Klaxon Co. v. Stentor Elec. Mfg. Co.* (Del., 1941), 61 S. Ct. 1021, 313 U.S. 47, 85 L. Ed. 1477.

This Court has before it a case of diversity of citizenship, and following the law laid down by the authorities above quoted, the trial Court should have necessarily found, as a matter of fact, that the California conflict of law rules apply to the facts here presented. That the California substantive law applied to whether or not there was a failure in the performance of the contract.

We respectfully submit to this Court that this was a material issue in the case, that a finding of fact should have been made on this issue and there not being such a finding of fact was prejudicial error to the Appellant.

III.

The decision erroneously states that an express warranty of description arose when the Appellant assured the Appellee the seeds were of first-class quality and of high germination. The uniform sales act defines an Express Warranty as "any affirmation of fact or any promise by the *seller* relating to the goods * * *".

In searching the transcript of record, we fail to find, even in the Appellee's testimony, any assurance made by the *Appellant* that the goods were true to type. Let us, for the sake of argument, assume that the Appellant had given an Express Warranty. Even then the Court in its opinion apparently did not consider the authorities directly on this issue, where a disclaimer of warranty is involved. The law on this subject has been set out in detail in Vol. 160, American Law Reports, page 360, and we respectfully request this Court that it consider these authorities.

One of the later cases involving the sale of seeds and dealing with a disclaimer clause is *Belt Seed Company v. Mitchellhill Seed Company,* 153 SW 2nd, 106. The Defendant wired the Plaintiff offering to sell grass seed of special weight and 77% purity and 80% germination. The Plaintiff wired the Defendant accepting a certain amount of the seed so quoted. The Defendant, on the day of the receipt of the telegram, accepting the offer of sale, confirmed the sale by letter on which letterhead was printed the Standard Seedman's Disclaimer, that the Defendant gives no Warranty, express or implied, as to description, quality or productiveness of any of the seeds it sends out, and will not be in any way responsible for the crop. The basis of the plaintiff's action was Breach of Warranty in that the seed did not test 80% germination. The Defendant appealed the adverse Judgment in the law Court, and the Appellate Court ruled in favor of the Defendant. The questions raised in this case

were substantially the same as the questions raised in the case at bar. The Court held the following:

> "So far as we are able to ascertain the authorities are unanimous in holding that, where the word 'warranty' or its equivalent does not appear in the contract, but there is some language appearing in it and it, and the surrounding circumstances, standing alone, might give rise to an inference merely that a warranty was intended, such inference cannot be drawn in the face of positive and explicit language in other parts of the contract showing that no warranty was given or intended, such as contained in the non-warranty provisions in the defendant's confirmation of sale and the letter of November 15th, 1927. Davis v. Bertrand Seed Co., 94 Cal. App. 281, 271 P. 123; Leonard Seed Co. v. Crary Canning Co., 147 Wis. 166, 132 N.W. 902, 37 L.R.A., N.S., 79, Ann. Cas. 1912D, 1077; Seattle Seed Co. v. Fujimori, 79 Wash. 123, 139 P. 866; Larson v. Inland Seed Co., 143 Wash. 557, 255 P. 919, 62 A.L.R. 444; Ross v. Northrup, King & Co., 156 Wis. 327, 144 N.W. 1124; Reynolds v. Binding-Stevens Seed Co., 179 Okl. 628, 67 P.2d 440; Manglesdorf Seed Co. v. Busby et al., 118 Okl. 255, 247 P. 410; Blizzard Bros. v. Growers' Canning Co., 152 Iowa 257 257, 132 N.W. 66; Miller v. Germain Seed & Plant Co., 193 Cal. 62, 222 P. 817, 32 A.L.R. 1215. 'Parties may by an express provision in the contract exclude any warranty as to kind from being imported from words descriptive of the kind of seed sold.' 24 R.C.L. p. 176.

> The question of whether a representation is a warranty depends on its having been affirmed as a fact; it must have been understood by the parties as having that character, it must be positive and unequivocal and not merely a vague, ambiguous, and indefinite statement of the seller regarding the property. A representation of fact made to induce the sale, and to be relied on, and which is relied on by the buyer, is a warranty unless accompanied by an express statement that it is not so intended, at least if the representation is understood by the parties as an absolute assertion. 55 C.J. pp. 677, 678, 679, 680. See, also, 24 R.C.L. pp. 164, 165. We are of the opinion that, under all of the circumstances, the statement by defendant that the seed would germinate 80% was merely the expression of an opinion. Davis v. Bertrand Seed Co., supra, 94 Cal. App. 281, 271 P. loc. cit. 126."

The Court will note that as the main authority for the ruling of the Judgment in this case the Court has repeatedly cited *Davis v. Bertram Seed Company,* 94 C.A. 281. We have constantly urged that the law of the State of California covers this transaction and by the law of the State of California, the defendant was not liable for Breach of Warranty.

In conclusion, the Appellant respectfully requests the Court that it correct its erroneous statement of facts set forth in its opinion to show that there was only one paper sent out and that was a Surplus List, and that on the Surplus List was printed a Disclaimer,

which negatived any statement that the seller, a seedman for twenty-five years, would feel would be a Warranty.

Dated, Stockton, California,
November 16, 1951.

Respectfully submitted,
JAMES I. HARKINS,
ALBERT E. CRONIN, JR.,
Attorneys for Appellant and Petitioner.

CERTIFICATE OF COUNSEL.

I, Albert E. Cronin, Jr., one of counsel for Appellant, hereby certify that in my judgment the foregoing petition is well founded and that it is not interposed for the purpose of delay.

Dated, Stockton, California,
November 16, 1951.

ALBERT E. CRONIN, JR.,
Of Counsel for Appellant and Petitioner.

24 pkgs 10pt + Stamtiffs Exhibit No. 7

OCT. 19 1943 D

THIS AGREEMENT, made in duplicate on _____, 19 __, by and between the

Standard Seed Farms Company, Seed Growers of Stockton, California, hereinafter called the Seller, and

hereinafter called the Purchaser

WITNESSETH 1. Seller agrees to sell and deliver and purchaser agrees to accept and pay for the varieties of seeds in the amounts, at the prices as set forth below, and subject to the terms and conditions herein provided

2. Seller agrees to plant, or cause to be planted, during the season of 19__ an acreage of land which will produce, under normal conditions, an amount of seed of the varieties herein named which will be sufficient to enable the Seller to deliver the quantities of the seeds herein contracted for; and the Seller agrees to deliver as soon as possible after harvest, such seeds in good merchantable condition, as herein defined, F.O.B. growing station, containers extra at cost, and not returnable. The term "in good merchantable condition" is defined as seeds properly cleaned for seeding purposes, approximately free from foreign seeds distinguishable by their appearance and of a germination equal to the fair average germination of the crop of the current year.

3. In case of partial or total failure of any or all crops planted for the purpose of producing the varieties of seeds herein named, or, in case of damage to any seed through fire, accident or other casualty beyond Seller's control, the Seller shall be obligated to deliver, if at all, proportional quantities only.

4. Purchaser shall make payment for seeds delivered by a trade acceptance due and payable 60 days from date of shipment, or by cash within 30 days from date of shipment, less a discount of 1½%.

If at any time, the financial condition of the Purchaser becomes unsatisfactory to the Seller, the Purchaser agrees upon receipt of written notice to that effect, and upon demand of the seller to pay for the seeds in advance of shipment, less a cash discount of 1½%, and if such payment is not made within ten (10) days from the receipt of such demand for payment, this agreement shall thereupon be deemed to be breached by the Purchaser.

5. Except as herein otherwise expressly provided, the Seller gives no undertaking or warranty, express or implied, as to description, quality, productiveness, or any other matter of any seeds sold by it and will not be in any way responsible for the crop.

6. Purchaser's claims for shortages of deliveries must be made to Seller immediately on receipt of shipment and all germination tests must be made and reported in writing (including telegrams) by Purchaser to Seller within 15 days after receipt of shipment.

IN WITNESS WHEREOF, the parties have hereunto set their hands on the day and year first above written.

Standard Seed Farms Company
The Seller

By _____

OFFERS made subject prior sale.

1943 CROP

By _____

QUANTITY	PRICE PER POUND

BEET

Crosby's Egyptian
Crimson Globe
Detroit Dark Red Turnip
Early Blood Turnip
Edmand's Blood Turnip
Extra Early Eclipse
Extra Early Flat Egyptian
Early Wonder
Mangels Danish Sludstrup
" Giant Intermediate
" Giant Long Red
" Half Sugar Rose
" Golden Tankard

CARROT

Runchine, special
Chantenay
Chantenay red core
Danvers Half Long
Early Scarlet Horn
Imperator 1.40
Improved Short White
Improved Long Orange
Nantes, coreless
Oxheart
Red St. Valiery
Yellow Belgian

CELERY

Golden Self-Blanching, Tall
Golden Self Blanching, Dwarf
White Plume
Giant Pascal .75
Ptah, green 2.75
Celeriac smooth Prague

ENDIVE

Broad Leaved Full hearted Batavian
Curled Leaved Green
Curled Leaved White
Pancalier, pink rib

LETTUCE

Big Boston, w s
Black Seeded Simpson b s 1.00
Denver Market w s
Early Curled Simpson w s
Grand Rapids b s
Hanson w s
Hubbard's Market, w s
Iceberg w s 1.10
Mat King, w s
New York, w.s. all types
" " Special
" " Number 12
" " **Imperial,** all types
Salamander b s
Prize Head w s 1.00
Paris White Cos w s
Silesia Early Curled w s
White Boston

LEEK

American Flag

MUSTARD

Chinese Broad Leaf
Giant Southern Curled
Fordhook Fancy
Ostrich Plume

ONION

Alisa Craig
Australian Brown
Ebenezer 3.00
Early Red Flat 2.85
Early Yellow Globe 3.00
Ohio Yellow Globe
Prizetaker
Red Wetherafield
Southport Red Globe 3.00
Southport White Globe
Southport Yellow Globe 3.00
Sweet Spanish, Valencia
Sweet Spanish, Riverside
Sweet Spanish, White
White Lisbon
White Portugal
White Silver Skin
Yellow Flat Danvers
Yellow Globe Danvers 3.00
Yellow Dutch, or Strasburg
Early Red Seal Globe 2.85

Crop Danvers 2.65

PARSLEY

Moss Curled
Plain Leaved
Turnip Rooted Hamburg

PARSNIP

Half Long Guernsey
White Hollow Crown

RADISH

China Rose .35
Crimson Giant
Early Scarlet Turnip
French Breakfast .35
Icicle
Long Scarlet Short Top
Long Brightest Scarlet
Scarlet Globe (Vicks) .35
Scarlet Half White
White Tipped Scarlet Turnip
White Vienna

SALSIFY

Mammoth Sandwich Island

SWEET PEAS

Eckford Mixed
Spencer Mixed Select

SWISS CHARD

Lucullus
White Ribbed, Smooth.

Our time and equipment is devoted exclusively towards developing and improving standard types of vegetable seeds as used by market garden and shippers' trade.

SHIPMENT RAIL OR WATER

MEMORANDUM

Plant Pest Control Extension No. 7

Standard Seed Farms Company

STOCKTON, CALIFORNIA

CONTRACT PRICE LIST

VEGETABLE SEEDS

SEASON OF

July, 1942

1943 CROP

CABLE ADDRESS
STANSEED

POST OFFICE BOX
No. 974